INDEX.

	PAGE
Table of References	iv
Cases Cited by Respondents	iv
Cases Cited by Petitioners and Distinguished	vii
Statutes	viii
Miscellaneous	x
Opinions Below	x
Preliminary Statement	1
Summary of Argument	3
Argument	5
RESPONDENTS' AFFIRMATIVE POINTS:	
POINT I. The Courts below were right in finding that the injunction order was necessary to permit the carrying out of the purpose of this reorganization proceeding under Section 77	5
When the application was made, there was imminent danger of the sale of the pledged System collateral	6
All of the bonds comprised in petitioners' collateral are obligations of the Rock Island System secured by System properties	8
To have left the collateral free for sale would have prevented reorganization	9
The findings of the Courts below	17
The Circuit Court of Appeals made no errors of fact	21

PAGE

POINT II. In a proceeding under Section 77 of the Bankruptcy Act the Court has power to issue an injunction order if necessary to carry out the purposes of the proceeding..... 25

REPLIES TO POINTS MADE BY PETITIONERS:

POINT III. There is nothing in Section 77 or other sections of the Bankruptcy Act or the R. F. C. Act which negatives the power of the Court to enjoin the sale of collateral when necessary for the enforcement of Section 77..... 37

(a) Subdivision (n) of Section 77 contains no limitation on the power to issue injunction orders under Clause (15) of Section 2 when necessary for the enforcement of Section 77.... 37

(b) Subdivision (l) of Section 77, giving the Court power to stay litigations, including litigations to enforce liens, is not a limitation on the power of the Court derived from other provisions of the Act to enjoin the sale of pledged collateral where necessary to carry out the proceedings..... 39

(c) Section 67(d), providing that liens shall not be affected by the Act, does not prohibit the issuance of injunctions against the use by pledgees of particular remedies for enforcing their pledges..... 41

(d) Section 57(h), providing in the alternative for the valuation of security (i) by sale or (ii) by agreement or litigation, does not negative the power of the Court to enjoin the sale of pledged collateral in a proper case..... 42

(e) There is nothing in the legislative history of Section 77 to show that Congress in-

PAGE

tended that the Courts should not enjoin the sale of collateral when necessary for the enforcement of that Section 45

(f) The powers given the R. F. C. by Section 5 of the R. F. C. Act are simply its own charter powers and have no bearing on the applicability to that corporation of general Federal legislation 47

POINT IV. The sale of this collateral was properly enjoined in this summary proceeding 49

(a) The application for the injunction was not an "adverse" claim and a plenary proceeding was not required 49

(b) The R. F. C.'s "demurrer" to the notice of motion 52

(c) The petitioners had ample notice and full opportunity to be heard 54

POINT V. Neither Section 77 nor Clause (15) of Section 2 is unconstitutional when construed to permit the courts to enjoin the sale of collateral when necessary for the enforcement of the Act 56

POINT VI. Section 77 has enlarged the territorial jurisdiction of the District Court in a proceeding under Section 77 so as to permit the issuance of process outside the district in a proper case 61

POINT VII. Discussion of general economic considerations urged by the R. F. C. and the Banks 68

Conclusion 75

Table of References.

PAGE

Cases cited by respondents:

Allebach v. *Thomas,* 16 F. (2d) 853 (C. C. A. 4th, 1927) 51

Baker Contract Co. v. *United States,* 204 Fed. 390 (C. C. A. 4th, 1913) 64

Boehmer v. *Pennsylvania R. R. Co.,* 252 U. S. 496 (1920) 20, 21

Building & Loan Ass'n v. *Blaisdell,* 290 U. S. 398 (1934) 59

Dold Packing Co. v. *Doermann,* 293 Fed. 315 (C. C. A. 8th, 1923) 51

Essanay Film Manufacturing Company v. *Kane,* 258 U. S. 358 (1922) 29

Ex Parte Southwestern Surety Ins. Co., 247 U. S. 19 (1918) 64

First National Bank v. *Williams,* 252 U. S. 504 (1920) 64

Fischer v. *Palmer,* 259 Fed. 355 (D. C., M. D., Pa., 1919) 64

French, Trustee v. *Hay,* 89 U. S. 250 (1874) 29

Hanover National Bank v. *Moyses,* 186 U. S. 181 (1902) 59

Highland v. *Russell Car Co.,* 279 U. S. 253 (1929) 58

Hitner v. *Diamond State Steel Co.,* 176 Fed. 384 (C. C., D. Del., 1910) 12

In re A. Musica & Son, 205 Fed. 413 (D. C., E. D., La., 1913), affd. 211 Fed. 326 (C. C. A. 5th, 1914), app. dis. 234 U. S. 263 (1914) 27

In re Battle Island Paper Co., 259 Fed. 921 (D. C., N. D., N. Y., 1919) 12

PAGE

In re Collier, 4 Fed. Supp. 700 (D. C., S. D., N. Y., 1933) 36, 38
In re Consumers Albany Brewing Co., 224 Fed. 235 (D. C., N. D., N. Y., 1915) 27
In re Cunney, 225 Fed. 426 (D. C., D. Mass., 1904) 54
In re Donnelly, 188 Fed. 1001 (D. C., N. D., Ohio, 1910) 27
In re Franklin Brewing Co., 249 Fed. 333 (C. C. A. 2nd, 1918) 56
In re Hesie, 206 Fed. 789 (D. C., N. D., Texas, 1913) 56
In re Hicks, 133 Fed. 739 (D. C., N. D., N. Y., 1905) .. 27
In re Hornstein, 122 Fed. 266 (D. C., N. D., N. Y., 1903) 27
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In re Nuttall, 201 Fed. 557 (D. C., S. D., N. Y., 1912) 27
In re Purkett, Douglas & Co., 50 F. (2d) 435 (D. C., S. D., Cal., 1931) 26, 28, 50
In re Rockford Produce & Sales Co., 275 Fed. 811 (C. C. A. 7th, 1921) 53
In re Snelling, 202 Fed. 258 (D. C., D. Mass., 1912) 53
In re Swofford Bros. Dry Goods Co., 180 Fed. 549 (D. C., W. D., Mo., 1910) 27
In re Van Buren, 164 Fed. 883 (D. C., S. D., N. Y., 1908) 27
In the Matter of Greyling Realty Corporation, Debtor, New York Law Journal, Jan. 17, 1935, p. 1 (C. C. A. 2nd, Jan. 7, 1935) 63
Isaacs v. *Hobbs Tie & Timber Company*, 282 U. S. 734 (1931) 42, 56
John Matthews, Inc. v. *Knickerbocker Trust Co.*, 192 Fed. 557 (C. C. A. 2nd, 1911) 26, 27, 34, 43, 50
Julian v. *Central Trust Co.*, 193 U. S. 93 (1904) 29
Kline v. *Burke Construction Co.*, 260 U. S. 226 (1922) 29

PAGE

Looney v. *Eastern Texas R. R. Co.*, 247 U. S. 214 (1918) 29, 30

Madisonville Traction Company v. *Saint Bernard Mining Company*, 196 U. S. 239 (1905) 29

Mississippi Valley Trust Co. v. *Railway Steel Spring Co.*, 258 Fed. 346 (C. C. A. 8th, 1919) 51, 73

Mitchell Storebuilding Co. v. *Carroll*, 193 Fed. 616 (C. C. A. 6th, 1912) app. dis. and cert. den. 232 U. S. 379 27

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New York v. *Irving Trust Co.*, 288 U. S. 329 (1933) .. 26

Pierce v. *United States*, 255 U. S. 398 (1921) 62

Southern Paving Const. Co. v. *City of Knoxville*, 245 Fed. 421 (C. C. A. 6th, 1917) 64

Straton v. *New*, 283 U. S. 318 (1931) 42, 56

Toland v. *Sprague*, 37 U. S. (12 Pet.) 300 (1838) 61

United States v. *Commercial Credit Co.*, 286 U. S. 63 (1932) 21

United States v. *Congress Const. Co.*, 222 U. S. 199 (1911) 64, 65

United States v. *Illinois Surety Co.*, 238 Fed. 840 (D. C., E. D., N. C., 1917) 64

Washington Securities Co. v. *United States*, 234 U. S. 76 (1914) 21

Weil v. *Neary*, 278 U. S. 160 (1929) 26, 51

Wells Fargo & Co. v. *Taylor*, 254 U. S. 175 (1920) 29

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	PAGE
Bush v. *Adams*, 165 Fed. 802 (C. C. S. D. N. Y., 1908)	34
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Guaranty Trust Co. v. *Fentress*, 61 F. (2d) 329 (C. C. A. 7th, 1932)	33
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Lynch v. *United States*, 292 U. S. 571 (1934)	58
Matter of Binghamton General Electric Company, 143 N. Y. 261, 38 N. E. 297 (1894)	34

PAGE

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Statutes:

United States Constitution:

Article I, Section 10 58
Fifth Amendment 56, 57, 58, 59
Fourteenth Amendment 57, 58

National Bankruptcy Act, as amended:

Section 2 (15) [11 U. S. C. A., §11 (15)], 3, 25, 26, 28, 30, 31, 35, 36, 38, 40, 41, 45, 50, 51, 56

Section 11 [11 U. S. C. A., §29] 36

Section 57(h) [11 U. S. C. A., §93(h)] 42, 43

Section 67(d) [11 U. S. C. A., §107(d)] 41, 42

Section 74 [11 U. S. C. A., §202] 30, 32, 36, 38, 46, 47

Section 74(h) [11 U. S. C. A., §202(h)] 46

Section 74(m) [11 U. S. C. A., §202(m)] 38

PAGE

Section 74(n) [11 U. S. C. A., §202(n)] 36

Section 75 [11 U. S. C. A., §203] 30

Section 77 [11 U. S. C. A., §205],
2, 3, 5, 6, 7, 9, 10, 16, 21, 25, 30, 31, 32, 33, 36, 37, 38, 41, 43, 45, 46, 47, 48, 50, 54, 56, 59, 60, 61, 66, 67, 72, 73, 74

Section 77(a) [11 U. S. C. A., §205(a)] 5, 31, 62, 63

Section 77(b) [11 U. S. C. A., §205(b)] 46

Section 77(c) (7) [11 U. S. C. A., §205(c) (7)] 5, 31

Section 77(g)(6) [11 U. S. C. A., §205(g)(6)] 43, 44

Section 77(h) [11 U. S. C. A., §205(h)] 46

Section 77(l) [11 U. S. C. A., §205(l)] 39, 40, 41, 42

Section 77(n) [11 U. S. C. A., §205(n)] 37, 38

Section 77B [11 U. S. C. A., § 207] 30, 63

Judicial Code:

Section 262 [28 U. S. C. A., §377] 28

Section 265 [28 U. S. C. A., §379] 29

R. S., Section 876, as amended by Act of Sept. 19, 1922, c. 344, 42 Stat. 848 [28 U. S. C. A., §654] 62

R. S., Section 985 [28 U. S. C. A., §838] 62

R. S., Section 986 [28 U. S. C. A., §839] 62

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	PAGE
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184 I. C. C. 597	9, 71, 72

Opinions Below.

No opinion was rendered by the District Court, but the grounds of its decision appear in its order (R., pp. 103-104).

The opinion of the Circuit Court of Appeals (R., pp. 313-326) is reported in 72 F. (2d) 443.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

IN PROCEEDINGS FOR THE REORGANIZATION OF THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY, Debtor.	
CONTINENTAL ILLINOIS NATIONAL BANK & TRUST COMPANY, *et al.*, Petitioners, *v.* THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY, *et al.*, Respondents.	Nos. 479-488.
RECONSTRUCTION FINANCE CORPORATION, Petitioner; *v.* THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY, *et al.*, Respondents.	Nos. 489-490.

On Writs of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

BRIEF FOR BONDHOLDERS PROTECTIVE COMMITTEES, RESPONDENTS.

Preliminary Statement.

This is a proceeding to review an order of the United States District Court for the Northern District of Illinois,

entered November 22, 1933 in proceedings under Section 77 of the Bankruptcy Act for the reorganization of The Chicago, Rock Island & Pacific Railway Company, Debtor, and certain subsidiary companies, also Debtors. The order enjoined the R. F. C. and five Banks, pending the further order of the Court, from selling $54,711,465 of mortgage bonds of the Rock Island System, secured by System properties, held by them as collateral security for $17,784,877 of promissory notes of the Debtor, on the ground that such injunction was necessary to permit the preparation and carrying out of a plan of reorganization under Section 77. It was entered on the application of the Debtor supported by respondent Bondholders Protective Committees. The order was unanimously affirmed by the Circuit Court of Appeals for the Seventh Circuit on July 23, 1934. The case comes before this Court on writs of certiorari granted December 3, 1934.

This brief is filed on behalf of three respondent Bondholders Protective Committees which are parties to the reorganization proceeding.

One of these Committees, the Committee for the First and Refunding Mortgage 4% Gold Bonds and Secured 4½% Gold Bonds, of which Mr. Dwight S. Beebe of The Mutual Life Insurance Company of New York is Chairman, represents the largest interest in the Rock Island System. There are outstanding in the hands of the public $104,470,000 of the First and Refunding Bonds, and $40,000,000 of the Secured 4½% Bonds (secured solely by pledge of $45,000,000 First and Refunding Bonds), and more than 50% of each issue has now been deposited with the Committee by almost 6,000 bondholders.

Another of these Committees, of which Mr. Ralph Wolf, formerly of Speyer & Co., is Chairman, represents the Convertible Gold Bonds, an unsecured issue, of which $32,288,000 of bonds are outstanding. The Committee has powers of attorney from the holders of substantial blocks of this issue.

The third Committee, of which Mr. Alfred H. Meyers of the New York Life Insurance Company is Chairman, represents the Consolidated First Mortgage Bonds of the Burlington, Cedar Rapids & Northern Railway Company secured by first mortgage on over twelve hundred miles of railroad now owned in fee by the Rock Island. Of this issue, $11,000,000 of bonds are outstanding in the hands of the public and $8,405,000 are pledged with the Trustees for the Rock Island's First and Refunding Mortgage. The Committee now has on deposit about 80% of the outstanding bonds of the issue.

Summary of Argument.

These respondent Committees make two affirmative points:

Point I. The courts below properly found that the injunction forbidding the sale of the collateral in question was **necessary** for the enforcement of the provisions of the Bankruptcy Act, and that the threatened sale of the collateral would prevent the consummation of a plan of reorganization under Section 77 of the Bankruptcy Act,—such reorganizations being the sole purpose of that section.

Point II. The Bankruptcy Court has power under Clause (15) of Section 2 of the Bankruptcy Act [11 U. S. C. A. §11 (15)] to issue such an injunction when it is **necessary** for the enforcement of the provisions of Section 77 of the Bankruptcy Act.

The remaining points in this brief are in reply to points made by the petitioners:

Point III will deal with the petitioners' claim that there are sections in the Bankruptcy Act and the Reconstruction Finance Corporation Act inconsistent with the decision below.

Point IV will deal with the petitioners' claim that the injunction was not properly issued in a summary proceeding.

Point V will deal with the petitioners' claim that the construction of the courts below was repugnant to the Fifth Amendment.

Point VI will deal with the claim of the petitioners that the court lacked jurisdiction to enjoin the three non-resident banks.

Point VII will deal with certain economic considerations urged by the petitioners.

ARGUMENT.

POINT I.

The Courts below were right in finding that the injunction order was necessary to permit the carrying out of the purpose of this reorganization proceeding under Section 77.

On June 7, 1933, the Chicago, Rock Island & Pacific Railway Company initiated under Section 77 [11 U. S. C. A., §205] of the Bankruptcy Act a reorganization proceeding in which a number of subsidiary railroad companies of the System shortly thereafter joined, all for the sole purpose of effecting a plan of reorganization of the Rock Island System* (R., pp. 2-5, 23-28, 92-99).

At the inception of the reorganization proceedings, the Rock Island System had outstanding $312,365,885 of funded debt, $17,784,877 of secured loans from the five Banks and the R. F. C., and $128,909,211 of preferred and common stocks (R., pp. 87-88), making a total of $459,059,973 of capitalization to be provided for in the reorganization plan, if the *status quo* were maintained.

But there were pledged an additional $200,460,515 of mortgage bonds and capital stock of the System as follows: $54,711,465 of Mortgage Bonds of the System with the Banks and the R. F. C. as security for the $17,784,877 of loans referred to above; $66,495,000 of Mortgage Bonds and $30,244,050 of capital stock of the System with the Trustees for the First and Refunding Mortgage; $45,000,000 of Mortgage Bonds of the System with the Trustee for the Secured 4½% Bonds; and $1,365,000 of Mortgage Bonds and

* That the sole purpose of this proceeding under Section 77 is to effect a reorganization of the Rock Island System is clear from a reading of the first and sixth sentences of Section 77, subdivision (a), and also from Clause 7 of subdivision (c) of Section 77, which provides that if a plan of reorganization is not proposed, accepted and confirmed within a reasonable time, the Court may dismiss the proceeding.

$2,645,000 of capital stock of the System with the Trustees for the General Mortgage (R., pp. 66-67).

Thus, if sales of this System collateral should be permitted to take place, the capital structure of the Rock Island System to be taken care of in the reorganization plan was subject to unpredictable expansion from time to time to the extent of an additional $200,000,000, or from an original capital of $459,000,000 to an expanded capital of up to $659,000,000, less any proceeds of the sales, which would be relatively small.

When the application was made, there was imminent danger of the sale of the pledged System collateral. Each of the collateral notes held by the R. F. C. and the Banks contained provisions that the holder might, **without notice,** at public or **private** sales, sell the collateral securing the same **to itself** or others (1) if the Railway Company should become insolvent, however such insolvency might be evidenced, or (2) if a receiver should be appointed of any of the property or assets or any part thereof of the Railway Company, or (3) if interest on the notes should not be paid when due (R., pp. 45, 46). Furthermore, the notes held by the Banks provided that a default in the payment of interest on the notes held by the R. F. C. would amount to a default in the notes held by the Banks (R., p. 40).

Two of these "events of sale" had occurred at the time of the application and the third was imminent. That is, (1) the Debtor had filed its petition under Section 77 stating that it was unable to meet its debts as they matured (R., p. 4), (2) the Court had entered an order taking the property of the Railway Company into the custody of the Court (R., p. 6), and (3) the funds in the hands of the Debtor and the earnings of the trust estate were not sufficient to provide for the interest on its senior mortgage bonds and the notes held by appellants (R., pp. 41, 42). Therefore, so far as the provisions of the collateral notes were concerned, the right of sale of the collateral existed and the danger of sale was imminent.

It was pointed out to the District Court that a decision that the R. F. C. and the Banks could not be enjoined from selling the $54,711,465 face amount of collateral held by them, would also determine that the Trustees of the three bond issues would have the right to sell (upon defaults under their indentures) the $145,749,050 total face amount of capital obligations of the System pledged with them, making a total of $200,460,515 of capital obligations of the System not now outstanding but free for sale at a fraction of face value (R., p. 67).*

Why any of the petitioners should contend that the decision upon this application will not determine whether the trustees for the bond issues are free to sell their collateral is difficult to understand. If the petitioners here cannot be enjoined, the bond issue trustees cannot be enjoined. If the petitioners here are enjoined, the Road's Trustees may apply for a similar injunction against the indenture trustees. While the order of the District Court did not enjoin the bond issue trustees from selling their collateral, it was because no application was made therefor; but the collateral held by the trustees was described in detail in the findings of the Court's order (R., p. 103), and the right, upon application, to enjoin them from selling it was expressly reserved in the Court's order (R., p. 104). Furthermore, the two bond issues under which substantially all ($141,739,050) of this additional collateral is pledged, are represented here on this appeal by the respondent Committee for the First and Refunding Mortgage 4% Gold Bonds and Secured 4½% Gold Bonds. Obviously, if this

* Notwithstanding that $141,739,050 of the above collateral was held to secure the two bond issues represented by the Committee for First and Refunding Bonds and Secured 4½% Bonds, that Committee supported the application and took the position that the interests of the bondholders it represented and of all of the creditors and of the Debtor's estate generally would best be served, and that the policy underlying the new Section 77 of the Bankruptcy Act would best be carried out, by a decision, the principle of which would show that the holders of claims secured by capital obligations of the System could be required to retain their collateral until a plan of reorganization could be prepared, approved and put into effect (R., p. 67).

injunction was properly obtained, a similar injunction can be obtained against the sale of the collateral under the two bond issues.*

All of the bonds comprised in petitioners' collateral are obligations of the Rock Island System secured by System properties. The petitioners draw some distinctions between blocks of the bonds in their collateral, and point out that some of them are not primary obligations of the Debtor. But all of the $54,711,465 of bonds pledged with the R. F. C. and the Banks are Rock Island System obligations secured on System properties. Some of the bonds held as collateral are direct obligations of the Principal Debtor, Chicago, Rock Island & Pacific Railway Company, others are indirect obligations of the Chicago, Rock Island & Pacific Railway Company, and some are obligations of subsidiaries which are either Debtors in this proceeding or would be forced to become such if these obligations of theirs were to be sold and become outstanding as primary obligations of the System.†

This bond collateral is divided into two classes—some is listed on the New York Stock Exchange and the balance is unlisted. The Debtor's application for the injunction

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* The contention of the R. F. C. that there is no proof before the Court of the fact that $145,749,050 of bonds and stocks of the Debtor's System were pledged with the Trustees for Debtor's bond issues is insubstantial, and the remark in the brief of the R. F. C. (p. 31) that no bond issue indentures were ever submitted to the Court is contrary to fact.

That such System bonds were pledged under such bond issues was directly alleged in the affidavit of Dwight S. Beebe (R., pp. 66, 67). While it was alleged "on information and belief," it was not controverted because a matter of record. Such allegations on information and belief are quite proper and customary in summary proceedings and must be taken as true unless controverted.

So far as concerns the statement of the R. F. C. that no bond issue indentures were ever submitted to the Court, the stenographic record of the proceedings in the District Court show that two indentures were submitted at the hearing on October 24, 1933, at which counsel for the petitioners herein were present. Furthermore, the Court was obviously familiar with the terms of the bond issue indentures with which it was constantly dealing in the proceedings and the collateral thereunder.

† There was pledged, in addition to these bonds, a claim estimated at $1,400,000 against the Railroad Credit Corporation which has been conceded throughout the proceedings below not to be a System obligation of the Rock Island.

stated, "All the [R. F. C.'s] unlisted collateral referred to above consists of First Mortgage Bonds of subsidiary companies of the Debtor's system" (R., p. 38).* Previous petitions of the Debtor had shown that the R. F. C.'s listed collateral, and all the collateral held by the Banks consists solely of (1) First and Refunding Mortgage Bonds of the Rock Island itself, (2) St. Paul & Kansas City Short Line First Mortgage Bonds guaranteed as to principal and interest by the Rock Island itself (R., p. 20), and (3) Rock Island, Arkansas & Louisiana First Mortgage Bonds, guaranteed as to principal and interest by the Rock Island itself (R., p. 4).

To have left the collateral free for sale would have prevented reorganization. It is obvious that a plan of reorganization which would take care of a readjustment of an outstanding capitalization of $459,000,000 would not take care of an unpredictable, but substantially increased, capitalization ranging up to $659,000,000, which would result from sales at fractions of their face amounts of all or portions of the $200,000,000 total of capital obligations of the System held as collateral.

Under Section 77 the plan must first be prepared by an authorized party, submitted and argued with any other plans before the Interstate Commerce Commission, approved by the Interstate Commerce Commission, assented to by two-thirds of each class of the creditors and stockholders, and approved by the District Court. The plan must then be put into effect through conveyances and the preparation, execution and issuance of new mortgage indentures, mortgage bonds, charter amendments and new stock certificates. Sales of blocks of the $200,000,000

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* It is to be noted that as to most of this unlisted collateral held by the R. F. C., the Interstate Commerce Commission said in its Report approving the loan made by the R. F. C. thereon:

> "The applicant states that all of the aforesaid collateral consists of first-mortgage bonds representing the only existing liens upon railroad and terminal properties in important cities used by and in the interest of the applicant and essential to the operation of its railroad system" (App. to Brief for R. F. C., p. 37; 184 I. C. C. 597).

of capital obligations of the System now held as collateral might take place from time to time while attempts were being made to prepare a plan of reorganization, to obtain the approval of the Interstate Commerce Commission, the assents of creditors and stockholders and the approval of the District Court, and to put the approved plan into effect. Each sale would require a modification of the plan, result in a change in the classes of claimants theretofore fixed by the Court, whose assents must be obtained to the plan, and nullify any proceedings on the plan theretofore taken before the Interstate Commerce Commission and the Court and also nullify assents by creditors and stockholders to the plan theretofore obtained.

The fundamental reason why sales of collateral consisting of obligations of the Debtor railroad System would prevent the reorganization of the System under Section 77 through the preparation, approval and carrying out of a plan of reorganization, is that the terms of the plan must give specific consideration to two definite factors: (1) the amount and classes of outstanding indebtedness and capitalization of the System, and (2) the figure taken as the assumed normal earning power of the System which is to support the new capital structure. The plan must definitely provide for new securities to replace all outstanding indebtedness and capitalization of each class, except that, of course, one or more senior issues not in default might be left undisturbed. The specific classes and amounts of securities to be outstanding after the plan is put into effect must be set up in the plan so as to take care of all theretofore outstanding securities of each class, and the new securities must be in such classes and amounts and have such terms that the figure taken as the assumed normal earning power will service them, otherwise it will be impracticable to set up, obtain assents to, and carry out a workable plan. Accordingly, even to perform the initial task of preparing a workable plan, it is necessary to know definitely the amount and classes of outstanding securities

which must be taken care of with the new securities, of types and with terms which can be serviced with this assumed earning power; and such outstanding securities can therefore not be subject to unpredictable shifts. Such unpredictable shifts would occur through the sale from time to time of blocks out of the total of $54,711,465 of the varied classes of System securities held as collateral by the petitioners, and also through the sale from time to time of blocks out of the total of $145,749,050 of the varied classes of System securities held as collateral for the bond issues.

Thus, if blocks of the $200,460,515 of System obligations securing the indebtedness held by petitioners and the trustees for the bond issues may become outstanding from time to time, it would be impracticable to prepare, obtain assents to, and put into effect a workable plan of reorganization.

And even the bare increase in the capitalization of the Rock Island System from $459,000,000 now outstanding to $659,000,000, which would result from the sale of the collateral without the receipt of any adequately compensating consideration therefor (due to the bankruptcy of the Debtor), would disastrously affect the acceptability to the creditors and stockholders whose assent thereto is necessary of any plan designed to take care of this expanded and diluted capitalization.

The R. F. C. argues that the pledged bonds are already "outstanding" and that there would therefore be no increase in the debt structure of the Rock Island as a result of their sale. But pledged bonds are not "outstanding" from the standpoint of the Rock Island System, which is the only sense in which we have here used the term; and the argument disregards the fact that while the pledged bonds are in the hands of the pledgees, the recovery on the primary debt *plus* the collateral is limited to the amount of primary debt, and overlooks the established rule that a creditor holding mortgage bonds of a debtor as collateral may not prove in bankruptcy on the promise contained in the

collateral bonds but only on the primary promise,—in other words, that in the pledgee's hands the collateral bonds in bankruptcy represent only a share in the mortgaged property of the debtor, the covenant to pay contained in the collateral bonds being given no effect. *In re Battle Island Paper Co.*, 259 Fed. 921 (D. C. N. D. N. Y., 1919). An extended discussion of the rule appears in *Hitner* v. *Diamond State Steel Co.*, 176 Fed. 384 (C. C. D. Del., 1910), an equity receivership case. On the other hand, on bonds really outstanding as primary indebtedness, the creditor realizes not only on the security but also on the covenant to pay.

The R. F. C. argues that, in the plan of reorganization, the obligations of the System which are now pledged will have to be taken care of by new securities in the same way, whether they are retained or sold (R. F. C. brief, p. 90). So far as this means that the holding by the R. F. C. and the Banks of the $54,711,465 of collateral securing the $17,784,877 of indebtedness must be fully recognized in the plan of reorganization, this is not only conceded, but asserted, by the Committee for the First and Refunding Mortgage 4% Gold Bonds and Secured 4½% Gold Bonds on behalf of the holders of the Bonds it represents for which $141,739,050 of capital obligations of the System are pledged. But the point is that all such collateral would have to be recognized in quite a different way if it is sold from the way in which it will be recognized if it is retained.

For example, if the R. F. C. and the Banks retain their collateral, not more than $17,784,877 in securities need be provided under the plan to retire these loans and take up the $54,711,465 of collateral. Their holdings of the $54,711,465 of collateral is nevertheless recognized in that it insures to them that they will receive better treatment than that accorded general creditors or poorly secured creditors of the System. But, if the R. F. C. and the Banks finally sell all their collateral, and even if it is assumed that the sales yield $17,784,877 and pay off the indebtedness

owed to them, the fact that the $54,711,465 of the System's obligations will have become outstanding in place of the $17,784,877 will require that, in order to recognize this collateral, up to $54,711,465 in lower grade securities must be provided in the plan of reorganization in place of $17,784,877 in cash or securities. This situation is, of course, magnified enormously in the similar situation existing with respect to the $145,749,050 of collateral of the System held by the Trustees for the outstanding bond issues.

The amounts of new securities which must be provided in any plan will be subject to enormous increase if the collateral is sold. It is almost equally important to point out that the kinds of new securities to be specified would be quite different. For example, if the $54,711,465 of heterogeneous R. F. C. and Bank collateral should become outstanding, the kinds of securities which must be issued to take them up in the reorganization will obviously be entirely different from the one class of security (or cash) which would be set up in the plan to retire the $17,784,877 of R. F. C. and Bank loans which are now secured by such $54,711,465 of collateral and to return such collateral to the Debtor. How can a definite plan be prepared, approved under the machinery of the Act, and carried out if a vastly greater amount of capital obligations of the System may become outstanding through sales from time to time of this collateral and the collateral held under the bond issues, when the new securities set up in the reorganization plan—the base of the whole plan—must increase in amounts and must change in kinds to provide different new securities which may be serviced by the assumed normal earnings and still be appropriate for offering in exchange for the shifting and new classes of system obligations?

The impracticability of preparing, obtaining assents to, and carrying out the plan, which flows from the continuing uncertainty as to when and what portions of such great mass of collateral of different classes will be sold, cannot be waved aside. Such sales might come in the course of

the preparation of a plan, or after a plan was formulated and being argued before the Interstate Commerce Commission, or after the Interstate Commerce Commission had approved a definite plan and assents thereto were being sought, or even after the Court had approved the plan and before it was consummated. The sales would destroy any such previously taken proceedings in two ways, viz.: (1) The sale of pledged bonds of an issue, no part of which is already outstanding in the hands of the public as primary debt, would create an entirely new and additional class of creditors, not only requiring a change in the plan to provide additional new securities to be offered in exchange, but also requiring obtaining the assent to the plan of the holders of this newly outstanding issue; and (2) the sale of pledged bonds of an issue, a portion of which is already outstanding in the hands of the public as a primary debt, not only would require a change in the plan to provide additial securities to be offered in exchange for these newly outstanding bonds, but would also expand this class of creditors, the assent of two-thirds of which must be obtained to the plan. Therefore, it seems obvious that freedom to sell this collateral is a menace to the whole proceeding.

The petitioners try to overcome this insuperable mechanical difficulty by contending that all the pledged bonds, although still held by the pledgees, must be counted in voting as if already outstanding as primary debts. They argue that therefore the sale of the pledged bonds will make no change in the classes of creditors from whom assents to the plan are required. For example, the petitioners would contend that the Rock Island & Dardanelle Railway Company First Mortgage Bonds, the entire issue of which is pledged with the R. F. C., already constitute a separate class of bonds, the holders of which must assent to the plan. This position is untenable. Petitioners' vote on the plan would simply be to decide whether to accept cash or high grade securities in exchange for their $17,784,877 of notes,

together with the collateral in which the Rock Island & Dardanelle Bonds are included, whereas the vote on the plan of a purchaser of the bonds from the petitioners would be to decide whether to take some different security in substitution solely for his Rock Island & Dardanelle Bonds.

Petitioners would likewise contend that the pledged First and Refunding Mortgage Bonds of the Rock Island itself, only a part of which issue is pledged, are now part of the class of such bonds consisting of the publicly held First and Refunding Bonds outstanding as primary debts, and that the holders of both the pledged and outstanding blocks of such issue together comprise the class whose assents must be obtained to the plan. This also is untenable. It would mean that pledgees of bonds of an issue with only a qualified pledge interest therein might control the entire class of holders of bonds of such issue who might, and probably would, have interests diametrically opposed to those of the pledgees. For example, take a debtor railroad system which has outstanding in the hands of the public $30,000,000 of first mortgage bonds and $100,000,000 of second mortgage bonds under which are pledged $70,000,000 additional of such first mortgage bonds as collateral. If the construction contended for by the petitioners were correct, the holders of the second mortgage bonds would vote in both classes of creditors and control by two-thirds vote what the public holders of $30,000,000 of first mortgage bonds would receive in the reorganization. This would be so, notwithstanding that the interests of the holders of bonds of the two issues outstanding in the hands of the public were necessarily conflicting.

The facts of this supposititious case are similar to the situation which exists in the Rock Island proceeding, where $38,400,000 of General Mortgage Bonds (a first mortgage), out of $99,981,000, are pledged under the First and Refunding Mortgage (which is junior to the General Mortgage on the property covered by the General Mortgage). If the pledged $38,400,000 of General Mortgage Bonds are in

the same voting class as the $61,581,000 of General Mortgage Bonds outstanding in the hands of the public, the First and Refunding Mortgage bondholders can combine their votes in respect of the $38,490,000 pledged General Mortgage Bonds with the votes of the holders of only $28,254,000 outstanding General Mortgage Bonds to make two-thirds of the total issue and force the holders of $33,327,000 of outstanding General Mortgage Bonds, constituting a **majority** of the outstanding General Mortgage Bonds, to take new securities wholly unacceptable to them. This is certainly not contemplated by Section 77, nor can any provision be found therein justifying such a construction. In fact, a pledgee holding obligations of the debtor as collateral is not a creditor in respect of such obligations, but only in respect of his primary debt. He receives the benefit of his collateral under Section 77 by being placed in a separate class of secured creditors on account thereof. His own class must either approve what the plan offers by two-thirds in amount or be paid off in cash.

In view of the unsupported statements made by the R. F. C. (R. F. C. brief, p. 96), particularly in the Courts below, that railroad systems have been regularly reorganized in equity with collateral loans outstanding and without injunctions against the sale of the collateral, we had a statistical study of the subject made. The results of the study show that only ten major railroad systems of the country (that is, of 1500 miles or more) have been in receivership **and have been reorganized** since 1910; and that in these ten cases there were no collateral loans or the collateral loans were of such a minor nature that they constituted no real factor in reorganization. This disposes of the assumption made by the R. F. C. which is unsupported by statistics of the history of railroad reorganizations. There is no showing that, at least since 1910, any major railroad system has been reorganized with any substantial collateral loans outstanding with the collateral free for sale. And the R. F. C. now concedes in its brief in this

Court (pp. 96-7) that the secured bank loans of railroads which have been reorganized in recent years were materially less than the petitioners' collateral loans in this case.

The Findings of the Courts below. On these facts and under these circumstances the District Court expressly found in its order that the issuance of the injunction was necessary to carry out the purposes of the reorganization proceedings, as follows (R., pp. 103-104):

> "* * * that the facts set forth in the petition of the Debtor, and in said affidavit of Dwight S. Beebe are true and accurate;
>
> "And it appearing to the Court that collateral owned by the Debtor of an aggregate face value of approximately $54,000,000, consisting of obligations of the Debtor and of subsidiary corporations, secured by mortgage lien upon properties constituting part of the Debtor's system of railroads, is pledged with the said Reconstruction Finance Corporation and said banks to secure indebtedness due March 1, 1934, aggregating approximately $17,784,877.58;
>
> "And it further appearing that approximately $66,495,000 face amount of bonds of the Debtor and of subsidiary companies of the Debtor's system of railroads, and $30,244,050 face amount of capital stock of said subsidiary companies, are pledged under the Debtor's First and Refunding Gold Bond Mortgage; and that $45,000,000 face amount of the Debtor's First and Refunding Mortgage 4% Gold Bonds are pledged under the Indenture securing the Secured 4½% Gold Bonds of the Debtor, and that $1,365,000 face amount of bonds and $2,645,000 face amount of capital stock of subsidiary companies of the Debtor's system are pledged under the General Gold Bond Mortgage of the Debtor;
>
> "And it further appearing that each of the said collateral notes contains provisions that if the Rail-

way Company shall become insolvent, however such insolvency may be evidenced, or if a receiver shall be appointed of any of the property or assets, or any part thereof, of the Railway Company, or if interest thereon be not paid when due, the holders thereof may sell and dispose of the collateral securing the same; and that there is danger that the holders of said notes will claim that one or more of the events entitling them to sell said collateral have occurred;

"And it further appearing to the Court that a sale of the said collateral, or any part thereof, by the Reconstruction Finance Corporation, or by the said banks, would be inconsistent with the purposes of Section 77 of Chapter VIII of the Acts of Congress relating to bankruptcy, and would hinder, impede, obstruct, delay, and in effect prevent the orderly preparation and consummation of a plan of reorganization of the trust estate under said Section 77, which is the sole purpose of said Section 77, under which these proceedings are now pending;

"And it further appearing that, under the provisions of Paragraph (a) of said Section 77, this Court, having approved the Debtor's petition, has during the pendency of these proceedings exclusive jurisdiction of the Debtor and its property, wherever located; and that under paragraph 15 of Section 2 of the Acts of Congress relating to bankruptcy, this Court has power to make such orders, issue such process, and enter such judgments, in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of the said Acts of Congress relating to bankruptcy;

"And it further appearing that it is necessary for the enforcement of the provisions of Section 77 that the said holders of said collateral be enjoined and restrained from selling or disposing of the same,

or any part thereof, pending the preparation and consummation of said reorganization plan;'"*

The Circuit Court of Appeals in all respects confirmed these findings of the District Court, saying (R., pp. 323-325):

"Surely, we are justified in giving to the amendment a liberal construction, one that is consonant with the purposes of this remedial legislation. That which distinguishes this section from the old act —the gist of the change evidenced by this amendment, that which makes it effective—is the provision which calls for a plan of reorganization. It calls not for a sale of assets and a discharge of the debtor, but for a plan of reorganization wherein the indebtedness and capital structure are changed (usually reduced) so that the debtor may live and the creditors will receive more than is obtainable upon a liquidation sale. The consummation of a fair and equitable plan of reorganization is the goal of the legislation. How could a plan of reorganization be perfected unless the courts restrained creditors and lienholders from proceeding in a manner which would defeat the consummation of said plan?

"In the instant case some fifty-four millions of dollars of the debtor's and its subsidiaries' bonds were hypothecated with creditors whose claims were scarcely one-third that amount. To successfully reorganize, it is necessary to take care of the funded indebtedness amounting to approximately two hundred and eighty millions of dollars. If, in addition thereto, fifty-four million dollars of bonds were beyond the control of the court, it would be quite impossible to proceed with any reorganization."

* * * * * * *

* The implied complaint of the petitioners that the District Court wrote no opinion is obviously ill founded in view of these specific findings and the grounds set forth therein.

"Our conclusion is that the restraining order is an exercise of authority on the part of the court which was **necessary** to the effective use of the powers expressly conferred by Congress through this amendment. • • •

"Upon the record before us we cannot say that the sale of the collateral by the pledgees will not defeat the purposes of Section 77. On the other hand, we agree with Judge Wilkerson that the facts called for an exercise of discretion on the part of the court in favor of the moving parties.

"The first impression might well be to the effect that the statement of appellants that they did not contemplate the sale of the securities obviated the necessity of an injunction. Such assurance by the creditors, however, was limited to a very short period —five days. The consummation of a reorganization plan of a railroad of the magnitude of the debtor, during which time the claims of the conflicting parties and interests must be considered, necessitates not five days but a much longer period, the exact duration of which cannot be prognosticated. Without some control over the disposition of $54,000,000 of bonds which have been hypothecated to secure nearly $18,000,000 of indebtedness, the presentation of a satisfactory plan of reorganization might as well be abandoned."

Thus the District Court found that the injunction was necessary in order to effect an orderly reorganization (R., p. 103), and this finding was unanimously approved and reiterated by the Circuit Court of Appeals (R., pp. 324-5).

This finding that the injunction was necessary was a finding of **fact**, even though it was an inference based upon undisputed primary facts.

Boehmer v. *Pennsylvania R. R. Co.*, 252 U. S. 496 (1920).

It was supported by evidence, and in view of the concurrence of the two courts below, should be accepted as conclusive by this court unless clearly erroneous.

United States v. *Commercial Credit Co.*, 286 U. S. 63 (1932);
Washington Securities Co. v. *United States*, 234 U. S. 76, 78 (1914).

This is particularly so since the District Court, having had jurisdiction of the proceedings under Section 77 of the Bankruptcy Act since the institution thereof, had a background of knowledge of the financial structure and affairs of the Rock Island System relevant to the necessity for the injunction, which no other Court could have. As was said by this Court in *Boehmer* v. *Pennsylvania Railroad Company*, 252 U. S. 496, 498 (1920), *supra*, when a matter depends on appreciation by the courts below of peculiar facts and the two courts below have agreed, this Court will not enter upon a minute analysis to overthrow their judgment.

It has already been shown that the findings of the District Court and of the Circuit Court of Appeals were right, and it will be briefly shown below that they did not even make any minor errors of fact, as petitioners contend.

The Circuit Court of Appeals made no errors of fact. Before concluding this discussion of the facts which were passed on by the courts below showing the necessity for the issuance of the injunction, it is pertinent briefly to point out that the Circuit Court of Appeals made no errors of fact as contended by the petitioners and also that, on their face, the statements of the Circuit Court of Appeals with which petitioners quarrel were not necessary to its decision.

(1) The R. F. C. and the Banks refer to the statement of the Circuit Court of Appeals that "appellants have received and will probably continue to receive the prompt payment of interest" (R., p. 325). This is really two statements, one of fact and one of mere surmise. The Court

has already reached its decision in the opinion before this sentence appears. As to the statement that the appellants have received interest, the Court was obviously speaking from the record and the record shows what was the fact, that interest was paid up to the time of the entry of the order (R., pp. 38, 40 and 77). The statement that the appellants "will **probably** continue to receive interest" is no more than a hope that financial conditions would warrant it and shows no reliance by the Court on continued payments.*

(2) The R. F. C. and the Banks claim that the Court erred in stating that the District Court sought to protect the great mass of the Debtor's creditors "without injuring the position of appellants" (R., p. 325). They claim that they were injured, and in support of this claim petitioners then give quotations of sales on the New York Stock Exchange of a few scattered bonds of some of the same issues, large blocks of which are pledged with them.

The argument based on these market quotations is fallacious. The loans were not short-term quick bank loans and were not made on the basis of market values of the bonds held as collateral but rather on the value of the System properties underlying the mortgage bonds comprised in the collateral (See Point VII, p. 71, *infra*).

Moreover, a reading of the opinion shows that what the Court meant was that the position of the petitioners in respect of their rights to retain and be secured by their collateral was not affected, which was correct.

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* In a footnote on page 73 of their Brief, the Banks say that they can receive no income from the pledged collateral because "the District Court authorized the Debtor's Trustees to refrain from paying the interest due" on the Short Line Bonds and the Debtor's First and Refunding Bonds. From this the impression might be formed that the orders referred to were specifically directed against the petitioners' receiving any distributions on the collateral pledged with them. But the fact is that the said orders applied to all the Debtor's outstanding bonds of those issues, whether pledged or not. Since the date of those orders, there have been some distributions on bond issues represented in the pledged collateral and the petitioners received the amounts applicable to such of these bonds as were pledged with them (R., p. 342), and will continue to receive their pro rata share of all distributions made on bond issues represented in their collateral.

Finally, if the R. F. C. and the Banks had considered that they had been injured in their substantive rights by the injunction order, they could have brought on their appeal to the Circuit Court of Appeals, their application for certiorari and the hearing on the merits in this Court in a few months instead of a year and a quarter.

(3) The petitioners claim that the Circuit Court of Appeals was wrong when it said:

> "The controversy was restricted to a restraining of the immediate pursuit of a remedy by the creditors in order that a plan might be presented which would take care of appellants' claims in full but without special and irreparable injury to the other creditors."

The petitioners charge that this statement was erroneous because there was no plan in existence at the time of the argument. Of course, the court never asserted any such thing.

The petitioners also charge that the statement was in error because there was nothing before the court which would warrant the statement that such a plan would "take care of appellants' claims in full." The court made no statement that any plan would take care of the appellants' claims in full. It made, not a statement as to what the plan would do, but of the end which it hoped would be achieved by the injunction,—a very different thing. Whether that end will be actually arrived at, none of us can in the nature of things know until a plan has been prepared and consummated, a process which cannot begin until this court sustains the injunction.

(4) The R. F. C. alone goes to some length to prove that the Circuit Court of Appeals is wrong in saying that *nine* wholly-owned subsidiaries under long term lease to the Debtor joined the reorganization proceedings and says that only six of these nine companies were under long-term

lease, and that three (Rock Island Memphis Terminal Railway Company, Rock Island Omaha Terminal Railway Company and Peoria Terminal Company) were under short-term lease. It contends that this is significant in showing that these three companies are not part of the Debtor's System and their obligations not System obligations. The absurdity of this is shown by the fact that they are all wholly-owned subsidiaries of the Rock Island, which makes it immaterial what the term of the lease may be (R., pp. 92-93).

(5) The R. F. C. contends that the Circuit Court of Appeals was wrong in stating that, if the petitioners' collateral is sold, a plan of reorganization will have to provide for all of the bonds of the Debtor and its subsidiaries comprised in the collateral. It states that three companies whose bonds are comprised in the collateral are not now in the reorganization proceedings, and discusses in considerable detail certain distinctions between different blocks of bond collateral comprised in the total of $54,711,465 face amount. These distinctions are obviously immaterial from the standpoint of this appeal, for we have shown (pp. 8-9) that the bonds held as collateral are all System obligations.*

(6) The R. F. C. alone states that the Circuit Court of Appeals failed to note that a claim against the Railroad Credit Corporation was comprised in the collateral and was not a bond of the System. This petitioner's statement is simply careless in view of the note to the table of collateral contained in the Court's opinion, which refers to this fact (R., p. 316).

* They are all bonds of companies which are debtors in this proceeding except for the bonds of the Rock Island Improvement Company, Trinity & Brazos Valley and Kankakee & Seneca. The Rock Island Improvement Company is a wholly owned subsidiary of the Rock Island which would be immediately forced into the proceeding if any of its obligations became outstanding. The Trinity & Brazos Valley and the Kankakee & Seneca are owned partly by the Rock Island and partly by other roads and have been operated jointly. The petition of the Debtor stated that these companies were subsidiary companies of the Rock Island System (R., p. 38). No evidence to controvert this was submitted by the R. F. C. or the Banks.

In concluding this comment upon the alleged errors of fact in the Circuit Court of Appeals' opinion; it should be pointed out that if the petitioners had considered these alleged errors really to be errors and material to the decision in the minds of that Court, they could have applied for a reargument. This they did not do and thereby showed that they did not think that Court could be induced to change its decision on the ground of these contentions.

Having shown that the issuance of the injunction was necessary to preserve the proceeding we shall now show that the Court had power to issue it.

POINT II.

In a proceeding under Section 77 of the Bankruptcy Act the Court has power to issue an injunction order if necessary to carry out the purposes of the proceeding.

We do not contend that a court in a proceeding under Section 77 has the general power to enjoin the sale of collateral irrespective of its nature and irrespective of the effect of the sale thereof on the reorganization. We contend for the limited principle that in a reorganization proceeding under Section 77 of the Bankruptcy Act, the court has power to issue injunction orders when necessary for the enforcement of the purposes of the Act, that is, reorganization.

We submit that the Bankruptcy Court has power in any type of proceeding under the Bankruptcy Act to issue an injunction order or any other order necessary to enforce the Act and carry out the purpose of that proceeding. Once the necessity is found, the power and jurisdiction to issue the order exists under the express provisions of clause (15) of Section 2 [11 U. S. C. A. §11(15)] of the Act which reads as follows:

> "The courts of bankruptcy • • • are hereby invested, within their respective territorial limits as established on July 1, 1898, or as they may be thereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings, • • • to • • • (15) make such orders, issue such process, and enter such judgments in addition to those specifically provided for as may be **necessary** for the enforcement of the provisions of this title."

In *Collier on Bankruptcy*, 13th edition, Vol. 1 (1923), pages 107, 108, the following appears concerning clause (15) of Section 2:

> "This is the omnibus clause of the section. Generally speaking, it may be availed of to compel anything which ought to be done for, or to prevent anything which ought not to be done against, the enforcement of the law; provided the court of bankruptcy otherwise has jurisdiction of the person or the subject-matter" (p. 107).
>
> "The power to enjoin is inherent in the court of bankruptcy as a court of equity. • • • That the broad phrasing of subdivision 15 amounts to an express ratification of this inherent power has not been doubted" (p. 108).

Clause (15) of Section 2 has been applied in a wide variety of ways by the Courts in the issuance of orders for the enforcement of the Act.

John Matthews, Inc. v. *Knickerbocker Trust Co.*, 192 Fed. 557 (C. C. A. 2nd, 1911);

In re Purkett, Douglas & Co., 50 F. (2d) 435 (D. C., S. D., Cal., 1931);

New York v. *Irving Trust Co.*, 288 U. S. 329, 331, 333 (1933);

Weil v. *Neary*, 278 U. S. 160, 169 (1929);

White v. *Schloerb*, 178 U. S. 542, 547 (1900);

Morehouse v. *Giant Powder Co.*, 206 Fed. 24, 28 (C. C. A. 9th, 1913);

Mitchell Storebuilding Co. v. *Carroll*, 193 Fed. 616, 619 (C. C. A. 6th, 1912), app. dis. and cert. denied 232 U. S. 379;

In re Consumers Albany Brewing Co., 224 Fed. 235 (D. C., N. D., N. Y., 1915);

In re A. Musica & Son, 205 Fed. 413, 416 (D. C., E. D., La., 1913); affd. 211 Fed. 326 (C. C. A. 5th, 1914); app. dis. 234 U. S. 263 (1914);

In re Nuttall, 201 Fed. 557, 558 (D. C., S. D., N. Y., 1912);

In re Donnelly, 188 Fed. 1001 (D. C., N. D., Ohio, 1910);

In re Swofford Bros. Dry Goods Co., 180 Fed. 549, 553 (D. C., W. D., Mo., 1910);

In re Van Buren, 164 Fed. 883 (D. C., S. D., N. Y., 1908);

In re Hicks, 133 Fed. 739, 745 (D. C., N. D., N. Y., 1905);

In re Hornstein, 122 Fed. 266, 270-271 (D. C., N. D., N. Y., 1903);

In re Kletchka, 92 Fed. 901 (D. C., S. D., N. Y., 1899).

Pursuant to the same general jurisdiction and power of the bankruptcy court, in *John Matthews, Inc.* v. *Knickerbocker Trust Co.*, 192 Fed. 557 (C. C. A. 2d, 1911), *supra*, the Circuit Court of Appeals affirmed the issuance of an injunction in an ordinary bankruptcy proceeding against the sale of collateral held by a pledgee where the collateral consisted of unsecured obligations of the bankrupt. Delivering the opinion of the Circuit Court of Appeals in that case, Judge Noyes said:

> "Any rule which would permit the proof of two notes for one indebtedness would permit the proof of a dozen and would substitute for *pro-rata* distribution among real creditors distribution in accord-

> ance with the ability of a bankrupt to make manifold obligations for single debts."

The Court there received its power to issue the injunction from the necessity of preventing the sale which would have defeated **equitable distribution** and thus have prevented the accomplishment of the purpose of ordinary bankruptcy proceedings.

And, in *In re Purkett, Douglas & Co.*, 50 F. (2d) 435 (D. C., S. D., Cal., 1931), *supra*, the bankruptcy court in an ordinary bankruptcy proceeding exercised such general power and issued an injunction against the sale of collateral where it was necessary for the carrying out of the purposes of the proceeding. The injunction was limited to the necessities of that proceeding. In that case the Court enjoined the sale of collateral until, and only until, certain conflicting claims regarding the pledged collateral could be adjudicated.

The authority of these cases has never been questioned.

Moreover a close analogy showing that the grant of power to enjoin when necessary is contained in Clause (15) of Section 2 appears in the line of cases in which this Court has held that a Federal Court, when **necessary** to prevent impairment or frustration of its jurisdiction, may issue an injunction under the general provision of the Judicial Code which reads:

> "The Supreme Court, the circuit courts of appeals, and the district courts shall have power to issue all writs not specifically provided for by statute, which may be **necessary** for the exercise of their respective jurisdictions, and agreeable to the usages and principles of law" [28 U. S. C. A., §377].

It is uniformly held that under this general section, where **necessary**, injunctions not authorized by any other statute may be issued against proceedings in state courts despite

the statue [28 U. S. C. A., §379*] specifically prohibiting injunctions against state court proceedings.

Kline v. *Burke Construction Co.*, 260 U. S. 226 (1922);
Essanay Film Manufacturing Company v. *Kane*, 258 U. S. 358 (1922);
Wells Fargo & Co. v. *Taylor*, 254 U. S. 175 (1920);
Looney v. *Eastern Texas R. R. Co.*, 247 U. S. 214 (1918);
Madisonville Traction Company v. *Saint Bernard Mining Company*, 196 U. S. 239 (1905);
Julian v. *Central Trust Co.*, 193 U. S. 93 (1904);
French, Trustee, v. *Hay*, 89 U. S. 250 (1874);
National Fire Insurance Co. v. *Sanders*, 38 F. (2d) 212 (C. C. A. 5th, 1930).

In *Kline* v. *Burke Construction Co.*, 260 U. S. 226 (1922), *supra*, this Court said (p. 228):

> "Section 265 of the Judicial Code provides: 'The writ of injunction shall not be granted by any court of the United States to stay proceedings in any court of a State, except in cases where such injunction may be authorized by any law relating to proceedings in bankruptcy.' But this section is to be construed in connection with §262, which authorizes the United States courts 'to issue all writs not specifically provided for by statute, which may be necessary for the exercise of their respective jurisdictions, and agreeable to the usages and principles of law.' See *Julian* v. *Central Trust Co.*, 193 U. S. 93, 112; *Lanning* v. *Osborne*, 79 Fed. 657, 662. It is settled that where a federal court has first acquired jurisdiction of the subject-matter of a cause, it may enjoin the parties

* "The writ of injunction shall not be granted by any court of the United States to stay proceedings in any court of a State, except in cases where such injunction may be authorized by any law relating to proceedings in bankruptcy."

from proceeding in a state court of concurrent jurisdiction **where the effect of the action would be to defeat or impair the jurisdiction of the federal court.**"

In *Looney* v. *Eastern Texas R. R. Co.*, 247 U. S. 214 (1918), the court said (p. 221):

> "The use of the writ of injunction, by federal courts first acquiring jurisdiction over the parties or the subject-matter of a suit, for the purpose of protecting and preserving that jurisdiction until the object of the suit is accomplished and complete justice done between the parties, is familiar and long established practice, *Freeman* v. *Howe*, 24 How. 450; *Harkrader* v. *Wadley*, 172 U. S. 148, 163, 164; in a rate case, *Missouri* v. *Chicago, Burlington & Quincy R. R. Co.*, 241 U. S. 533, 543."

Similarly, a bankruptcy court derives from Clause (15) of Section 2 full power to issue injunctive orders when necessary to carry out the purposes of the Bankruptcy Act in the particular proceeding.

It must be borne in mind that there are now several different kinds of bankruptcy proceedings, each with a different purpose, viz.: (1) an ordinary bankruptcy proceeding, the purpose of which is orderly **liquidation** and equitable **distribution** to creditors; (2) a proceeding under Section 74 [11 U. S. C. A. §202], the purpose of which is to obtain a **composition** and **extension for an individual**; (3) a proceeding under Section 75 [11 U. S. C. A. §203], the purpose of which is to obtain a **composition** and **extension for a farmer**; (4) a proceeding under Section 77 [11 U. S. C. A. §205], the purpose of which is to effect the **reorganization of a railroad**; and (5) a proceeding under Section 77B [11 U. S. C. A. §207], the purpose of which is to effect the **reorganization principally of industrial corporations.**

It is obvious that the necessity for any particular type of injunction order in bankruptcy depends upon which of

these types of proceedings is involved. An injunction of a particular type which is unnecessary in one type of proceeding might be necessary in another.

When Section 77 was inserted in the Bankruptcy Act a new purpose of a proceeding under the Act was introduced. It is clear from a reading of Section 77 that the sole purpose of a proceeding thereunder is to permit a railroad "to effect a plan of reorganization." (First sentence of subdivision (a) and clause (7) of subdivision (c) of Section 77) [11 U. S. C. A. §205 (a) (c) (7)].

That the purpose was to reorganize not only the parent railroad corporation but the entire **system**, including subsidiaries and leased lines, is shown by the provisions of Section 77 permitting all such system corporations to come into the proceeding, as debtors, and into the same District Court as the principal debtor irrespective of the location of such corporations or their lines. (Sixth sentence of subdivision (a) of Section 77) [11 U. S. C. A., §205 (a)].

Since the purpose of a proceeding for **reorganization** of a railroad under Section 77 is so different from the purpose of an ordinary bankruptcy proceeding involving **liquidation** and **distribution** of the bankrupt's estate, it follows that cases as to injunctions under the one type of bankruptcy cannot be cited blindly as authorities in connection with the other type of bankruptcy, for the power to enjoin arises always from the necessity of the injunction and the necessities are different in connection with these two different types of bankruptcy. Thus, in an ordinary bankruptcy proceeding, if collateral securing a claim against the bankrupt was of such a nature that realization thereon would not interfere with orderly liquidation and equitable distribution, there was no necessity and therefore no power, to enjoin the sale pursuant to Clause (15) of Section 2.

Where the collateral consists of chattels or bonds which are the obligations of a third party, realization thereon does not increase the indebtedness of the bankrupt but constitutes simply a liquidation of a portion of its assets and a

distribution thereof to the creditor entitled thereto, leaving him with an unsecured claim against the bankrupt estate for the deficiency, if any. Accordingly, in ordinary bankruptcy proceedings courts did not usually need to, and therefore did not, enjoin the sale of collateral of this type.

In re Hudson River Navigation Corporation, 57 F. (2d) 175 (C. C. A. 2nd, 1932);
In re Mayer, 157 Fed. 836 (C. C. A. 2nd, 1907).

And these respondents do not now see any necessity even in proceedings under Section 77 or Section 74 for enjoining, generally, the sale of pledged collateral of that type—that is to say, collateral which is not secured by System property.*

In an ordinary bankruptcy there would be no necessity for enjoining the sale of collateral consisting of secured bonds of the bankrupt itself, if the sale of the secured bonds would not interfere with the orderly liquidation and equitable distribution of the estate, that is, if virtually the face amount of the pledged secured bonds would be realized. Only one decision has been cited by petitioners holding that the sale of that type of collateral would not be en-

* Injunctions against the sale of collateral consisting of obligations of **third parties** have been refused in proceedings under Section 74. We would expect this since such sales would not interfere with the purposes of proceedings under Section 74 or for that matter under Section 77 or ordinary bankruptcy proceedings. Accordingly *In the Matter of Charles P. Doelger, Debtor*, 9 American Bankruptcy Review, 329 (June, 1933), D. C. S. D. N. Y., and *In the Matter of H. F. Chaiken, Debtor*, 10 American Bankruptcy Review, 14 (August, 1933), D. C. M. D. Pa., cited by petitioners, where injunctions against the sale of this type of collateral were refused in proceedings under Section 74, are not in point. They were applications by individual Debtors in proceedings under Section 74 of the Bankruptcy Act to enjoin holders of their notes from selling securities which they held as collateral for such notes. **The collateral did not consist of obligations of the Debtor either secured or unsecured**, but simply ordinary more or less readily marketable securities issued by others. There is no indication that the sale of such collateral interfered in any substantial degree with carrying out the purposes of the proceedings under Section 74. These respondents do not claim that in such circumstances in a proceeding under Section 74 or under Section 77 or in ordinary bankruptcy the Court should issue an injunction. It is therefore quite obvious that these two decisions are no authority whatever as to the propriety of the issuance of an injunction in this proceeding under Section 77 against the sale of collateral of the type and amount held by the Banks and the R. F. C., with the effect such sale would have on this proceeding.

joined in an ordinary bankruptcy proceeding. *In re Ironclad Mfg. Co.*, 192 Fed. 318 (C. C. A. 2nd, 1912). In that case no facts appeared showing that the sale of the collateral would interfere with the orderly distribution and liquidation of the estate. The case is therefore not authority for the proposition that the sale of collateral consisting of secured bonds of the bankrupt will not be enjoined in ordinary bankruptcy even if the sale would interfere with liquidation and distribution.

It should also be pointed out that the decision in that case is simply a memorandum of two lines and rests on a mistaken view of the holding in *Jerome* v. *McCarter*, 94 U. S. 734, which is also misconstrued by the petitioners herein. *Jerome* v. *McCarter* was an equity receivership, and there was no question of enjoining the sale of any collateral. The Court simply held that bonds of the company in receivership, which had previously been collateral for obligations of that company and had been sold prior to the equity receivership, could be proved in the equity receivership. It happened that the sale had taken place during a prior bankruptcy, in which no application to enjoin the sale had been made.

The other cases cited by the petitioners as showing that Bankruptcy Courts, prior to the enactment of Section 77, did not enjoin the sale of this type of collateral do not stand for that proposition.

In *Turner* v. *Metropolitan Trust Co.*, 207 Fed. 495, 499 (C. C. A. 9th, 1913), the sale of the collateral took place **before** the bankruptcy.

Guaranty Trust Company of New York v. *Galveston City R. Co.*, 87 Fed. 813 (C. C. A. 5th, 1898), and *Rogers Brown & Co.* v. *Tindel Morris Co.*, 271 Fed. 475 (D. C. E. D. Pa., 1921), were cases of **equity** receiverships.*

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* All of the other cases cited by petitioners which relate to the question of injunctions against the sale of collateral are cited by them only as showing (1) the rule in equity receiverships:

Guaranty Trust Co. v. *Fentress*, 61 F. (2d) 329 (C. C. A. 7th, 1932) (*dictum*);

On the other hand, the decisions are uniform that where an injunction against the sale of collateral or any other injunction is shown to be necessary to carry out the purposes of an ordinary bankruptcy proceeding, the Courts have power to issue them. We have already referred to *John Matthews, Inc.* v. *Knickerbocker Trust Co.*, 192 Fed. 557 (C. C. A. 2nd, 1911), where an injunction was issued in an ordinary bankruptcy proceeding against the sale of collateral consisting of unsecured obligations of the bankrupt on the ground that the injunction was necessary because the sale would interfere with equitable distribution among the creditors. Petitioners do not question the authority of this case.

While no case seems to have arisen in ordinary bankruptcy, one can readily be imagined where the sale of collateral consisting of secured obligations of the bankrupt would interfere with the purposes of an ordinary bankruptcy proceeding. We have no doubt that in such a case the Court would enjoin the sale. Suppose a bankrupt cor-

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International Banking Corporation v. *Lynch*, 269 Fed. 242 (C. C. A. 9th, 1920);
Matter of Binghamton General Electric Company, 143 N. Y. 261, 38 N. E. 297 (1894) (involving statutory dissolution proceedings);
Northern Pacific Railway v. *Frank Waterhouse & Co.*, 279 Fed. 750 (D. C. W. D. Wash., 1922);

or (2) the rule in ordinary bankruptcy regarding injunctions against the sale of collateral consisting of obligations of third parties or chattels:

In re Browne, 104 Fed. 762 (D. C. E. D. Pa., 1900);
In re Hudson River Navigation Corporation, 57 F. (2d) 175 (C. C. A. 2nd, 1932);
In re Mayer, 157 Fed. 836 (C. C. A. 2nd, 1907);
In re Jersey Island Packing Co., 138 Fed. 625 (C. C. A. 9th, 1905) (*dictum*).

The following cases cited by petitioners on this point do not even involve the question of injunctions against the sale of collateral:

Bush v. *Adams*, 165 Fed. 802 (C. C. S. D. N. Y., 1908);
Dibert v. *Wernicke*, 214 Fed. 673 (C. C. A. 6th, 1914);
Harvey v. *Smith*, 61 N. E. 217 (Mass., 1901);
In re Mertens, 144 Fed. 818 (C. C. A. 2nd, 1906), aff'd. *sub nom.* Hiscock v. Varick Bank of New York, 206 U. S. 28 (1907);
In re Ward, 104 Fed. 985 (D. C. D. Mass., 1900);
Mercer Nat. Bank of Harrodsburg v. *Whites Ex'r*, 32 S. W. (2d) 734 (Ky., 1930);
Risk v. *Kansas Trust & Banking Co.*, 58 Fed. 45 (C. C. D. Kan., 1893)

poration had given a creditor for $10,000 security consisting of its $20,000 bond secured by mortgage on a vacant lot worth $1,000. The sale of this collateral would interfere with equitable distribution of the estate in an ordinary bankruptcy proceeding almost to the same degree as would the sale of collateral consisting of unsecured obligations of the bankrupt. An injunction against the sale thereof would be necessary for the enforcement of the purposes of an ordinary bankruptcy proceeding and should be issued. Petitioners have presented no authority showing that an injunction would not have been issued in such a case even in ordinary bankruptcy. The Banks (in their brief, pp. 20, 55, 75) seem to cite with approval on other points *Hatch, "A Form of Depression Finance—Corporations Pledging their own Bonds,"* 47 H. L. Rev. 1093, an exhaustive article on the subject which holds the view that an injunction should be issued against the sale of pledged bonds of the bankrupt in ordinary bankruptcy.

However that may be, cases which deal with the necessity of enjoining the sale of this particular class of collateral in a proceeding designed primarily for orderly **liquidation** and equitable **distribution**, have no real bearing on the question of the necessity of enjoining the sale of this class of collateral in a proceeding the sole purpose of which is **reorganization**.

It seems obvious that **the introduction in the Bankruptcy Act of a provision for a new proceeding with a new purpose, i.e., reorganization, will call for new applications of the power of bankruptcy courts** under Clause (15) of Section 2 to issue injunctive and other orders necessary for the enforcement of the Act and the carrying out of the purposes of the new proceeding.

That the new sections of the Bankruptcy Act providing for new proceedings with new purposes have called for new applications of the power of the bankruptcy courts to issue injunctive orders under Clause (15) of Section 2 when necessary to carry out the new purpose

appears from *In re Collier*, 4 Fed. Supp. 700 (D. C. S. D. N. Y. 1933). That case was a proceeding under Section 74 having the purpose of obtaining for an individual debtor a composition and extension of his debts whether provable or not in ordinary bankruptcy. The court enjoined the continuation of a suit in a State court on an unsecured claim assumed by the court not to be provable in ordinary bankruptcy. The court did so notwithstanding that Section 74 did not contain any express provision for enjoining an unsecured creditor, and Section 11 of the old Bankruptcy Act [11 U. S. C. A., §29] (incorporated into Section 74 by subdivision (n)) [11 U. S. C. A., §202 (n)] provided for, and only for, enjoining suits on debts provable and dischargeable in ordinary bankruptcy. The court quoted Clause (15) of Section 2 of the Act permitting it to enter such orders as may be necessary for the enforcement of the Act, and held that under this provision it had the authority to grant the injunction applied for, despite the fact that no such injunction could have been entered in an ordinary bankruptcy proceeding and that there was no express provision authorizing such injunction in Section 74.

We submit that the issuance of the injunction against the sale of petitioner's collateral in this Section 77 proceeding is but an example of another such new application of the undoubted power of the Bankruptcy Court to issue an injunction order if **necessary** to preserve the purpose of the proceeding.*

The remaining points in this brief are in reply to points made by the petitioners.

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*The R. F. C. seems to imply (R. F. C. Brief, p. 31) that, even though it be held that the petitioners herein cannot be enjoined, the Trustees for the Rock Island bond issues may be enjoined from selling the $145,749,050 of System collateral held by them. The R. F. C. differentiates the two situations solely on the length of term of the original loans. But, certainly, if the Court has jurisdiction and power to enjoin the sale of the collateral pledged under the bond issues, it must have jurisdiction and power to enjoin the sale of the collateral pledged to the petitioners.

POINT III.

There is nothing in Section 77 or other sections of the Bankruptcy Act or the R. F. C. Act which negatives the power of the Court to enjoin the sale of collateral when necessary for the enforcement of Section 77.

(a) Subdivision (n) of Section 77 contains no limitation on the power to issue injunction orders under Clause (15) of Section 2 when necessary for the enforcement of Section 77.

The petitioners claim that subdivision (n) of Section 77 incorporates into Section 77 all of the rules and decisions in ordinary bankruptcy existing before the enactment of Section 77, and that such decisions include decisions (of which we have shown there is really only one, pp. 32-33 herein), prior to enactment of Section 77, in which an injunction against the sale of collateral consisting of secured obligations of the bankrupt was refused by a bankruptcy court. They say that therefore such decisions (only one) are controlling in proceedings under Section 77, notwithstanding the difference in purpose of the proceeding from the purpose of ordinary bankruptcy.

There are a number of conclusive answers to this argument. Subdivision (n) [11 U. S. C. A., §205 (n)] reads as follows:

> "In proceedings under this section **and consistent with the provisions thereof, the jurisdiction and powers of the court,** the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and his property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

(1) Subdivision (n) is a **grant** of power to the Court over the Debtor and its property and thus cannot be con-

strued as a **limitation** upon the power of the Court requiring the Court to adhere blindly to now inapplicable precedents.

(2) Subdivision (n) begins with a proviso that the powers and jurisdiction granted therein must be "consistent" with the provisions of Section 77. Accordingly, if as we contend, it is inconsistent with the purposes of the provisions of Section 77 (all of which look toward reorganization) to permit pledgees to sell collateral where the effect of the sale would prevent the preparation and consummation of a plan of reorganization, no provision contained in subdivision (n) and no decision in ordinary bankruptcy inconsistent with the purposes of Section 77 could operate to prevent the Court from issuing this injunction. Therefore, since subdivision (n) contains this proviso, any argument based on the subdivision or such decision begs the real question at issue upon this application.

(3) We do not claim that the general **powers** of the Court to issue injunctions necessary for the enforcement of the Act are enlarged by Section 77, but merely that the existence of Section 77 calls for a **new application** of these general powers. Therefore it is immaterial that subdivision (n) of Section 77 does not contain express enlargement of these general powers.

(4) Furthermore, we have already shown (pp. 35-36) that the Courts have applied the broad injunctive powers contained in Clause (15) of Section 2 in a new way in aid of the enforcement of the new purpose of Section **74** notwithstanding that Section 74 contains a provision, subdivision (m) [11 U. S. C. A. §202 (m)], similar to this subdivision (n) of Section 77 [11 U. S. C. A. §205 (n)].

In re Collier, 4 Fed. Supp. 700 (D. C. S. D. N. Y., 1933).

Clearly a provision such as subdivision (n) in Section 77 can only enlarge the powers of the Court and cannot be

deemed a limitation on the powers of the Court. Particularly it cannot be deemed a limitation that would prevent the Court from enforcing and carrying out the purpose of the provisions of the very section in which it is incorporated.

(b) Subdivision (l) of Section 77 giving the Court power to stay litigations, including litigations to enforce liens, is not a limitation on the power of the Court derived from other provisions of the Act to enjoin the sale of pledged collateral where necessary to carry out the proceedings.

Petitioners call attention to subdivision (l) of Section 77 [11 U. S. C. A. §205 (l)] which was obviously written with the purpose in mind of controlling litigation against the debtor, and which, therefore, incidentally provides for staying litigation to enforce liens. Petitioners cite the maxim *expressio unius est exclusio alterius*, and say that because Congress gave express power to stay judicial proceedings, including judicial proceedings for the enforcement of liens, Congress intended to negative the power to enjoin enforcement of liens by means other than judicial proceedings.

There is a short answer to this argument of the petitioners. Subdivision (l) simply deals with the subject of controlling litigation, including litigation to enforce liens upon the estate, and is a grant of power to the Court to control litigation. A subdivision which constitutes a grant of power in connection with the subject of controlling litigation cannot be stretched by any logical process into a limitation of power in connection with a subject which does not involve litigation. Subdivision (l) simply has nothing to do with injunctional or other orders which do not relate to litigation. It certainly cannot be construed, as contended by the R. F. C., as containing the only injunctional powers of the Bankruptcy Court.

The maxim *expressio unius est exclusio alterius* might be used in the construction of subdivision (l) in a case

where an injunction was applied for against the **commencement** of a judicial proceeding not designed to enforce a lien. In such case, it could be urged in opposition to the issuance of an injunction that since subdivision (l) provides for an injunction against a **pending** judicial proceeding not designed to enforce a lien, but makes no reference to enjoining **commencement** of such a judicial proceeding, it was intended that an injunction should not issue against **commencement** of a judicial proceeding not designed to enforce a lien. But the maxim certainly cannot be stretched to imply a limitation upon the injunctional power of the court **on subjects other than judicial proceedings.**

To argue that, because the right to enjoin is specifically given by subdivision (l) in one class of case, it cannot exist in other and quite different classes of cases, is to argue that the general powers clause, Section 2, Clause (15), is no longer in effect. But that clause was inserted in the statute for the precise purpose of preventing deficiencies of power and miscarriages of the proceedings resulting from the failure of specific sections expressly to state all the powers required by the Court for the purpose of making proceedings under the Act effective.

Since we do not claim that the power to issue this injunction order is contained in subdivision (l), we shall not discuss the argument of petitioners that subdivision (l) does not give the power. But in conclusion on this point the attention of the Court should be called to the fact that the petitioners themselves urge that their "pledges" are not "liens" and contend therefore, that in case subdivision (l) were to be construed as applicable to enjoining enforcement of liens without judicial proceedings (for which construction no one contends), their pledges would not be affected by subdivision (l), which uses the word "liens" alone (R. F. C. brief, pp. 51-55; Banks' brief, p. 38). This argument of theirs certainly weakens petitioners' contention that subdivision (l) has any bearing on the subject of their "pledges."

Also, the argument of petitioners that subdivision (l) should be construed to negative the power of the Court to issue injunctions in proceedings under Section 77 against the sale of collateral seems to us to be virtually destroyed by the statements in the R. F. C. brief (p. 31) implying that even though petitioners cannot be enjoined, the Trustees for the Rock Island bond issues may be enjoined from selling the System collateral held by them. If there is power to enjoin the bond issue Trustees, notwithstanding subdivision (l), there must be power to enjoin the petitioners, notwithstanding subdivision (l).

(c) Section 67 (d), providing that liens shall not be affected by the Act, does not prohibit the issuance of injunctions against the use by pledgees of particular remedies for enforcing their pledges.

The petitioners claim that old Section 67 (d), although not referred to in new Section 77, guarantees to them the right at any time to sell their collateral and therefore limits the application of Clause (15) of Section 2.

There is no merit to this contention. Section 67 (d) simply provides that "liens" shall not be affected by anything in the Bankruptcy Act. Section 67 (d) [11 U. S. C. A. §107 (d)] reads:

> "*d.* Liens given or accepted in good faith and not in contemplation of or in fraud upon the provisions of this title, and for a present consideration, which have been recorded according to law, if record thereof was necessary in order to impart notice, shall, to the extent of such present consideration only, not be affected by anything herein."

The section merely affirms the substantive right of lienors to retain their security unimpaired, but does not apply to, much less guarantee, their remedies. Petitioners' argument from Section 67 (d) is entirely fallacious when it is borne in mind that notwithstanding the existence of

such Section—which covers mortgage liens to precisely the same extent as any others—the Courts have held up the enforcement of mortgage liens even in ordinary bankruptcy proceedings.

Straton v. *New*, 283 U. S. 318, 321 (1931);
Isaacs v. *Hobbs Tie & Timber Company*, 282 U. S. 734 (1931).

There is obviously no such difference between a pledge and a mortgage as would warrant the protection of pledgees' remedies, as contrasted with the remedies of a mortgagee, under the general provisions of Section 67 (d).

It should also be borne in mind that petitioners' contention that subdivision (l) of Section 77 relating to "liens" has no application to "pledges", is inconsistent with their argument here that Section 67 (d) relating to "liens" applies to their "pledges" (R. F. C. brief, pp. 51-55; Banks' brief, p. 38).

(d) Section 57 (h), providing in the alternative for the valuation of security (i) by sale or (ii) by agreement or litigation, does not negative the power of the Court to enjoin the sale of pledged collateral in a proper case.

The petitioners contend that Section 57 (h) [11 U. S. C. A. §93 (h)] indicates that security held by secured creditors must always remain free for sale. The Banks, in their brief (p. 22), quote only one-half of the sentence which constitutes Section 57 (h), and argue from this emasculated provision that the Bankruptcy Act contemplates that secured creditors are always to have the right to sell their collateral. Section 57 (h) reads as follows (NOTE: Brackets enclose that portion of the sentence which is omitted by the Banks and which is the basis here, and has been the basis in the Courts below, for respondents' answer to the petitioners' contention):

"The value of securities held by secured creditors shall be determined by converting the same into

money according to the terms of the agreement pursuant to which such securities were delivered to such creditors or [by such creditors and the trustee, by agreement, arbitration, compromise, or litigation, as the court may direct, and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance]."

Thus Section 57(h) simply provides in general terms that security held by secured creditors may be valued in either of two ways, that is, by sale **or by agreement or litigation.** The section merely takes care of two alternative situations, either of which may occur—one is where security actually is sold, the other is where security is not sold. The section in no way indicates that a sale of security by a secured creditor must occur or will not be interfered with in a proper case. That this is so, is borne out by decisions, just cited (p. 42), enjoining the sale of mortgaged security through foreclosure and the decision in *John Matthews, Inc.* v. *Knickerbocker Trust Co.*, 192 Fed. 557 (C. C. A. 2d, 1911), enjoining the sale of collateral security when in the form of unsecured obligations of the bankrupt.

Furthermore, the section by its terms shows that it is intended only to provide for the fixing of the amount upon which a secured creditor in an ordinary bankruptcy is to receive a dividend. The whole purpose of this provision of the old Bankruptcy Act obviously lies in its concluding words "and a dividend shall be paid **only** on the unpaid balance." It therefore has no possible application to a proceeding under Section 77 which is to result in a reorganization and not in a distribution of dividends.

In addition to making the general argument that Section 57 (h), as part of the old Bankruptcy Act, is applicable to a proceeding under Section 77, the Banks seem to argue (Banks' brief, pp. 23-24, footnote, p. 41) that it has been incorporated in its entirety into Section 77 by a reference thereto in Section 77 (g) (6) [11 U. S. C. A., §205 (g) (6)].

It is difficult to see what assistance petitioners can draw from Section 77 (g) (6).* The language of Section 77 (g) (6) does not assist the petitioners. On the contrary, the language, if it has any bearing here, supports respondents' contentions. In the first place, the clause refers only to realization by creditors upon their liens, claims and securities by any method **under a plan**, and not prior to the adoption of a plan. But more important, the clause expressly provides for three possible alternative methods for the protection of secured creditors. Under this clause the plan is to provide either [Section 77 (g) (6) (a)] for the sale of their securities subject to their liens, or [Section 77 (g) (6) (b)] for the sale **free of such liens but at not less than a fair upset price to be fixed under the supervision of the Court and the Interstate Commerce Commission**, or [Section 77 (g) (6) (c)] for **appraisal** of the liens or the new securities allotted in exchange therefor under the plan. The only type of sale discussed by petitioners here is a sale free of lien, and Section 77 (g) (6) (b) states that such a sale must be under the supervision of the Court and the Commission, thus indicating that the collateral is, and will remain, subject to the jurisdiction of the Court until a plan is prepared, adopted and carried out. It is significant that the clause expressly empowers the Court and the Commission to place a limitation on the sale by fixing a minimum price at which the securities may be sold.

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*"*g*. Upon such approval by the commission, and after hearing such objections as may be made to the approved plan, the judge shall confirm the plan if satisfied that * * * (6) the plan provides with respect to any class of creditors the acceptance of which is requisite to the confirmation of the plan, and who would not become bound by the plan under the provisions of subdivision (h) of this section, adequate protection for the realization by them of the value of their securities, liens, and claims, either (a) by the sale of such property subject to their liens, if any, or (b) by the sale free of such liens at not less than a fair upset price, and the transfer of such liens to the proceeds of such sale, or (c) by appraisal and payment in cash of either the value of such liens and claims or, at the objecting creditors' election, the value of the securities allotted to such liens and claims under the plan. Section 57, clause (h), of this Act shall be applicable to the appraisal of securities under this section, and the value of the unpaid balance shall be appraised as an unsecured claim; * * *. In the case of a sale or appraisal under clause (5) or (6) of this subdivision (g) the court shall refer to the commission for its consideration and determination the amount to be fixed as the upset price and the appraisal of any securities." [11 U. S. C. A. §205 (g) (6)].

(e) There is nothing in the legislative history of Section 77 to show that Congress intended that the Courts should not enjoin the sale of collateral when necessary for the enforcement of that Section.

A number of references have been made by petitioners to remarks in debates in Congress and before Congressional Committees, in an attempt to show that Congress did not intend to give to the Courts the power to enjoin the sale of collateral in any case.

Before any Congressional debates can be introduced to assist in the construction of a section of a Federal statute, there must be an ambiguity in the section. The only sections of statutes relied on here by the respondents are Clause (15) of Section 2 of the Bankruptcy Act, and the express purposes set forth in Section 77 of the Act. Therefore, it is only if these are ambiguous that introduction of Congressional debates would be warranted.

There is no ambiguity here. This is admitted by the Banks which say (Br., p. 46): "there is no ambiguity in Section 77 as to the point at issue," and by the R. F. C., which says (Br., p. 57): "there is no ambiguity in Section 77 on the questions here presented,".

But we need not rely on these admissions. The clear language of Clause (15), of Section 2 empowers the Court to issue orders which are **necessary** for the enforcement of the Act and the protection of the purposes of the particular bankruptcy proceeding. The clearly expressed and undisputed purpose of Section 77 is reorganization. What orders are **necessary** for the enforcement of the Act and to protect the proceeding does not involve an ambiguity, but is an issue for judicial determination upon the circumstances of the particular case. Recourse cannot be had to remarks of Congressmen as a criterion from which to review a judicial determination of necessity.

In this connection we cannot go along with the argument of the R. F. C. that, because it does not think the group which sponsored Section 77 had in mind enjoining

the sale of collateral as one of the purposes to be accomplished by the enactment of the Section, a court therefore should not enjoin the sale of collateral even when found necessary by the Court to carry out the admitted purpose of Section 77—reorganization. The sponsors of Section 77, having secured the passage of the legislation as a part of the Bankruptcy Act, are not entitled to direct its inevitable judicial results.

In any event, the only three instances of alleged expressions of Congressional intent relied on by the petitioners do not bear them out.

Petitioners refer (R. F. C. Br., p. 58; Banks' Br., p. 47) to a report of the Senate Committee on Judiciary regarding Section 74. They admit that no report was filed regarding Section 77, but they quote the portion of the report on Section 74 relating to subdivision (h) of Section 74 which describes the class of creditors' secured debts which may be extended in a Section 74 proceeding. This class is limited to "secured debts, the security for which is in the actual or constructive possession of the debtor or of the custodian or receiver." The report states that the secured debts extended by Section 74 were so limited, so that ordinary collateral loans would not be so extended under Section 74. Not only does the report not refer to Section 77, but when we turn to Section 77 we find that the secured debts affected by that section are described without the words of limitation contained in Section 74. For instance, subdivision (b) of Section 77 [11 U. S. C. A. §205 (b)] provides:

> "A plan of reorganization within the meaning of this section (1) shall include a proposal to modify or alter the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise."

and subdivision (h) of Section 77 [11 U. S. C. A. §205 (h)] provides:

> "Upon such confirmation, the provisions of the plan shall be binding upon * * * (7) all secured creditors of each class of which two-thirds in amount shall have accepted the plan."

Thus, there is no qualifying phrase in Section 77 as in Section 74, and there is a compelling inference that collateral loans are to be affected by proceedings under Section 77.

Petitioners quote an answer on the floor of the House to a question as to what effect Section 77 would have on the status of Government loans to the railroads, as contrasted with investments of the public in stocks and bonds of railroads. The answer was: "They are not given by this bill any preferred status which they do not now have, and to whatever degree now preferred the status is not lessened. They are not disturbed." (R. F. C. Br., p. 59; Banks Br., pp. 47-8.) It seems to us that the statement has no bearing on the question at issue in this case.

Finally, petitioners refer (R. F. C. Br., p. 59; Banks' Br., p. 48, footnote) to a collection of data relating to amending the Bankruptcy Act, printed for use of the Senate Committee on Judiciary, containing, among a mass of suggestions from private individuals, one proposed plan, among the provisions of which was included express provision for enjoining pledgees from converting collateral. There is no basis for the implication urged by petitioners that this provision, suggested by this one of many private individuals, was specifically rejected by the Congress or even given any serious attention.

(f) The powers given the R. F. C. by Section 5 of the R. F. C. Act are simply its own charter powers and have no bearing on the applicability to that corporation of general Federal legislation.

The argument of the R. F. C. that Section 5 of the Act [47 Stat. 5, 6, 7] which incorporated the R. F. C. and gave it its powers, providing that the R. F. C. is to have the

power to take over or provide for the administration and liquidation of collateral accepted by it as security, constitutes a part of every Federal statute of general application and gives it a special position in proceedings under Section 77 of the Bankruptcy Act, is so untenable as to make us hesitate to lengthen this brief by discussing it. It is sufficient to state that the R. F. C. Act is simply the charter, certificate of incorporation, or articles of association of the R. F. C. and gives it no more special rights under the general statutes of the United States or in its courts as against third parties than does the charter, certificate of incorporation, or articles of association of any other Federal corporation.

The argument of the R. F. C. regarding the effect of Section 5 of the R. F. C. Act can be reduced to an absurdity. Take one of the loans made by the R. F. C. secured by mortgage on railroad property. Would the R. F. C. assert that Section 5 of the R. F. C. Act guaranteed its right to liquidate that loan in the only way possible, that is, by foreclosure, notwithstanding the provisions of Section 77, and while other mortgage holders are prevented from foreclosing?

Again, would the R. F. C. assert that because of Section 5 of the R. F. C. Act, it can realize on security held by it for a railroad loan in any manner it saw fit without being subject to any control of the Court? That is, would it assert that it could sell in an oppressive manner to itself for a nominal consideration and not have the sale reviewed by any Court?

The R. F. C. brief, at pages 21 and 69, says: "These acts [incorporating and granting powers to the R. F. C.] were not considered by the Circuit Court of Appeals in its opinion," and "The statutory power of the Reconstruction Finance Corporation to take over and liquidate collateral was not passed upon by the Circuit Court of Appeals." The R. F. C. seems to imply that the point was raised by

it below and that the Circuit Court of Appeals in error ignored it. The fact is that the point is raised here for the first time.

POINT IV.

The sale of this collateral was properly enjoined in this summary proceeding.

The Banks and the R. F. C. say that the proceeding should have been plenary and not summary and also that, even if the proceeding was properly a summary proceeding, the moving and supporting papers were insufficient and they had inadequate notice and opportunity to be heard.

(a) The application for the injunction was not an "adverse" claim and a plenary proceeding was not required.

The petitioners contend that the District Court had no power in this summary proceeding to issue an injunction against the sale of collateral. They urge that by the application for an injunction the Debtor was attempting to enforce an **adverse** claim to the pledged property in a summary proceeding, whereas the proper procedure to enforce an adverse claim to property was by a plenary suit.

We do not question the proposition that **adverse** claims to property, where the person in possession has more than colorable right, must be made in a plenary suit. This application for an injunction, however, does not constitute the assertion of an **adverse** claim to the collateral. The Debtor does not assert that the pledges are invalid, or that the pledgees have not the right to possession of the pledged property as security for the Debtor's notes. No attack was made on the substantive rights of the pledgees or on the position to be accorded the pledgees in the plan of reorganization on account of their holding this large amount of collateral; and no relief was applied for which would do

more than delay the use by the pledgees of their remedies. [Petitioners have continued to receive distributions made on their collateral, which amounted, between September 26, 1933, and October 4, 1934, to $376,270 (R., p. 342).] In other words, no **adverse** claim to the collateral was advanced by this petition, which relates solely to the pledgees' remedies and not to their substantive rights.

Furthermore, the Debtor and these respondents are not seeking to assert any right which the Railway Company might have had prior to bankruptcy against the pledgees in respect of the collateral. We admit that whatever power this Court has to issue the injunction flows solely from the power of a Court of Bankruptcy to alter remedies of creditors so that they do not unduly interfere with the purpose of the bankruptcy proceeding and the enforcement of the Act. We admit that if no bankruptcy proceeding had been commenced, no right to this injunction would exist; and our contention rests solely on the power of the Bankruptcy Court to protect the proceeding pending in that Court. This being so, no plenary suit could be brought in any other court to obtain this injunction, but the power must be exercised by the Bankruptcy Court itself, if it is to be exercised at all.

This is not a mere matter of argument; there is direct authority that an injunction of this character may be issued in **summary** proceedings. In the cases where an injunction against the sale of collateral was issued by Bankruptcy Courts before the enactment of Section 77 the procedure was summary. The remedy of sale of pledged collateral was interfered with in summary proceedings in *John Matthews, Inc.* v. *Knickerbocker Trust Co.*, 192 Fed. 557 (C. C. A. 2nd, 1911), and in *In re Purkett, Douglas & Co.*, 50 F. (2d) 435 (D. C. S. D., Cal., 1931). In thirteen other cases which we cited earlier (pp. 26-27) as showing the varied situations in which the courts have applied clause (15) of Section 2, the courts invariably acted in summary proceed-

ings.* Also the right of foreclosure of a mortgage was interfered with in summary proceedings in *Allebach* v. *Thomas*, 16 F. (2d) 853 (C. C. A. 4th, 1927). The authority of these cases has never been questioned.

Likewise, in equity proceedings in jurisdictions where the rule is that the sale of collateral of this type may be enjoined, these injunctions are issued in **summary** proceedings. *Mississippi Valley Trust Co.* v. *Railway Steel Spring Co. et al.*, 258 Fed. 346, 354 (C. C. A. 8th, 1919). This is so notwithstanding that the rule in equity receiverships is the same as that in bankruptcy, that **adverse** claims must be made by **plenary** suit. *Dold Packing Co.* v. *Doermann et al.*, 293 Fed. 315, 331 (C. C. A. 8th, 1923).

The Circuit Court of Appeals dealt adequately with this point in its opinion (R., p. 324):

> "Nor can we say the appellants, the claimants, occupied such an adversary status that a trial in a plenary suit was necessary. The trustees named by the court in the bankruptcy proceedings were not claiming adversely to appellants. The creditors were not claiming liens or title to property adverse to the trustees. The trustees admit the legality of the security held by the creditors, as well as the validity and amount of the creditors' claims.
>
> "The controversy was restricted to a restraining of the immediate pursuit of a remedy by the creditors in order that a plan might be presented which would take care of appellants' claims in full but without special and irreparable injury to other creditors, general and preferred, who were less fortunate in the amount and character of their security.

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* *Weil* v. *Neary*, 278 U. S. 160 (1929), is not an exception because clause (15) of Section 2 was involved only collaterally in that case. What was directly involved was the validity of a contract made in violation of a court rule, and it was held that the rule in question was properly promulgated by the bankruptcy court under the power granted in clause (15) of Section 2.

> "Our conclusion is that the restraining order is an exercise of authority on the part of the court which was necessary to the effective use of the powers expressly conferred by Congress through this amendment. In short, it was the exercise of a power which was incident to those expressly conveyed by Congress to the court. The proceeding involved no adversary contest but merely the pursuit of a remedy. The court violated no right of the appellants of which they could complain when it temporarily stayed the enforcement of their remedy arising out of the pledge of the collateral. *Home Building & Loan Ass'n* v. *Blaisdell*, 290 U. S. 398."

(b) The R. F. C.'s "demurrer" to the notice of motion.

The R. F. C. tries to place the application for this injunction in the category of plenary suits, to liken the notice of the application to a bill of complaint, and then to "demur" to the notice as if it were a bill of complaint and have it dismissed for failure, standing alone, to contain all of the elements of some cause of action. In support of this proposition counsel for the R. F. C. cites cases where bills of complaint in plenary suits in equity have been dismissed as insufficient because not containing the necessary elements of the cause of action attempted to be alleged. In some of these cases the bills of complaint were accompanied by supporting affidavits which the Courts held should be ignored in determining the sufficiency of the bills themselves.

From these cases counsel for the R. F. C. argues that the Court upon this application should have looked only to the facts set forth in the Debtor's notice of motion and attached application, and not to those contained in the other papers submitted in support of the application, or to the facts of general record in the Rock Island proceeding well known to the Court. They then argue that all the facts upon which the Court based its decision were not contained

in the application and the application should therefore have been denied.*

But the R. F. C. has lost sight of the clear distinction between a summary application and a plenary suit. In a summary application such as this, the party affected need only originally be given notice of the relief sought. The facts may then be placed before the Court by any party by affidavit or by oral testimony. The application in a summary proceeding is merely a notice of motion and is not demurrable. These characteristics of a summary proceeding in bankruptcy were described in *In re Rockford Produce & Sales Co.*, 275 Fed. 811 (C. C. A. 7th, 1921), where Judge Evans said at page 813:

> "A summary proceeding ordinarily implies one begun without summons or subpoena and is usually tried upon affidavits and upon short notice, or determined even as an *ex parte* matter."

That a summary proceeding in bankruptcy is not subject to anything in the nature of a demurrer was stated in *In re Snelling*, 202 Fed. 258 (D. C., D. Mass., 1912), by Judge Morton, viz.:

> "It is plainly a summary proceeding. *In re* Epstein, 156 Fed. 42, 84 C. C. A. 208, 17 L. R. A. (N. S.) 465. I share the doubts expressed by Lowell, J., in *re* Mullen (D. C.), 101 Fed. 413, and *re* Berkman (U. S. District Court, Massachusetts, No. 3,266, April 11, 1901), 201 Fed. 180, as to the propriety of a demurrer in summary proceedings. Summary procedure implies, I think, a single hearing in each tribunal, at which the merits of the controversy

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* If the matters in the general record of the Rock Island proceeding are not pertinent to this application and appeal, as asserted by the R. F. C., why, then, did it and the Banks print this voluminous transcript containing almost the entire record? It is a new theory of litigation to us, which is urged by the R. F. C. that this voluminous record may be used to attack the District Court's order but not to support it (R. F. C. Brief, p. 29).

are investigated and decided, without much regard to the formal pleadings."

The R. F. C. also asserts that the Federal equity rules apply in bankruptcy proceedings, implying that the Equity Rules are to be used in summary bankruptcy proceedings as well as plenary proceedings and it cites General Order in Bankruptcy 37. A reading of General Order 37 itself shows that the Equity Rules apply in bankruptcy only in **equity proceedings** brought to enforce the provisions of the Bankruptcy Act and also that the rules may be departed from by the Judge to facilitate a "speedy hearing." Also, it is held that the Equity Rules have no application to a **summary** proceeding in bankruptcy. *In re Cunney, et al.*, 225 Fed. 426 (D. C. D. Mass., 1904).

Obviously, the essential facts could not be disputed, that is, the character and amount of the outstanding indebtedness of the System and of the collateral held therefor, which were all a matter of record. These facts (plus the sole purpose of a proceeding under Section 77—reorganization) were all the facts requisite for the determination by the Court that the injunction against the sale of the particular collateral held by petitioners was necessary to carry out the purpose of this proceeding. Whether the R. F. C. is right or wrong regarding the right to demur to the application, all these essential facts are contained in the application itself and the application would be sufficient standing alone.

(c) The petitioners had ample notice and full opportunity to be heard.

The petitioners question the essential adequacy of their notice and hearing under the summary proceedings.

The order entered June 8, 1933 approving the Debtor's original petition contained general language enjoining interference with the Debtor's property in effect constituting an injunction against the sale of collateral, and this

order was served on the six petitioners (R., p. 114). Subsequently, ten days' notice by registered mail was given each of the Banks and the R. F. C. of an application to be presented to the Court on September 26, 1933 for the specific injunction here appealed from (R., pp. 37-58). Each of the Banks and the R. F. C. appeared specially by counsel on September 26, 1933, and took part in the oral argument and discussion. At that hearing, counsel for the Banks and the R. F. C. stipulated not to sell the collateral without five days' notice to the Debtor (R., p. 76-77) after the Court stated that otherwise it would restrain them pending the decision (Banks' Brief, p. 9). Two briefs were submitted in support of the application on behalf of two of these Protective Committees, and the Banks and the R. F. C. by stipulation obtained the right to file answering briefs and to argue **on the merits** without prejudice to their special appearances (R. F. C. Brief, p. 8). A short time thereafter, the Banks and the R. F. C. filed four briefs and an appendix in opposition to the application, and two of the Protective Committees filed a reply thereto. Two of the Banks also filed a lengthy letter in opposition, a reply to which was filed by one of the Protective Committees. On October 24, 1933, a further hearing was held, and the R. F. C. and one of the Banks handed up two more memoranda in opposition to the injunction. The injunction order was signed November 22, 1933.

Obviously, on this record the petitioners cannot complain that they were not given ample opportunity to contest the application.

POINT V.

Neither Section 77 nor Clause (15) of Section 2 is unconstitutional when construed to permit the Courts to enjoin the sale of collateral when necessary for the enforcement of the Act.

The Banks alone contend that an injunction against the sale of collateral would be such an impairment of the obligation of contract as to constitute a deprivation of property without due process of law, contrary to the Fifth Amendment. The R. F. C. raises no constitutional question.

An injunction against the sale of collateral is but a restraint, incidental to the exercise of the bankruptcy power of Congress, against the use of a particular remedy for the enforcement of the pledge. This has been long established in the case of mortgage security. The enforcement of remedies under mortgages has been enjoined in bankruptcy and the restraint on the enforcement of such remedies has been held to be constitutional.

Straton v. *New*, 283 U. S. 318, 321 (1931);
Isaacs v. *Hobbs Tie & Timber Company*, 282 U. S. 734 (1931);
In re Franklin Brewing Co., 249 Fed. 333 (C. C. A. 2nd, 1918);
In re Hesie, 206 Fed. 789 (D. C., N. D. Texas, 1913).

In *In re Franklin Brewing Co.*, 249 Fed. 333 (C. C. A. 2nd, 1918), a mortgaged property securing an issue of bonds was ordered sold in bankruptcy free and clear of the lien of the mortgage. The mortgage provided that the outstanding bonds could be used in paying the purchase price of the mortgaged property on any sale, but the designed effect of the lower court's procedure was to prevent the use of the bonds in the manner provided in the mort-

gage. The sale produced less than the amount of the mortgage bonds. The trustee under the mortgage, on behalf of the bondholders, appealed from the order of sale. The Circuit Court of Appeals upheld the order, saying (p. 335):

> "Nor does a mortgage clause giving the right to bid on bonds in any way limit the power of the court, however much it may influence its discretionary application.
>
> "Congress, in the exercise of its constitutional right to establish systems of bankruptcy, may, and indeed always does, impair the obligation of contracts; a doctrine going much further than this point requires. Mitchell *v.* Clark, 110 U. S., at page 643, 4 Sup. Ct. 170, 312, 28 L. Ed. 279; Canada, etc., Ry. *v.* Gebhard, 109 U. S., at page 539, 3 Sup. Ct. 363, 27 L. Ed. 1020. Therefore we find in the order directing sale free of lien nothing unlawful, nor any abuse of discretion amounting to error of law, which is the only error available here upon a petition to revise. There was a drastic exercise of authority, but no intimation is intended that circumstances might not justify it as matter of discretion."

The Banks are infelicitous in the arguments which they advance to support their contention that the Bankruptcy Act, if construed to authorize the injunction order entered below, is unconstitutional. They assert (pp. 63-4) that the bankruptcy power of Congress is subject to the "due process" clause of the Fifth Amendment. Then they say (p. 64) that since there is a "due process" clause in the Fourteenth Amendment directed against action by the states, cases arising under the Fourteenth Amendment involving state legislation are, therefore, applicable to federal legislation subject to the Fifth Amendment. But when they then proceed to quote from five cases (Banks' Brief, pp. 65-7) to show that the taking away of a remedy under a contract is unconstitutional, they fail to point out that

four of the five cases arise neither under the Fifth Amendment nor the Fourteenth Amendment, but involve state legislation and have only to do with Article I, Section 10 of the Constitution, prohibiting a state from "**impairing the obligation of contracts,**" and that the fifth case is likewise not in point.* Obviously, these cases lend no support to their argument.

Certainly it cannot be that the Banks contend that the prohibition against impairment by a state of the obligation of contracts is co-extensive with the "due process" requirement of the Fifth Amendment and is thus a restraint on the bankruptcy power of Congress. Nothing is better settled than that Congress may regulate the making and performance of contracts in connection with any of the express purposes for which the Federal government was created. Thus, in *Highland* v. *Russell Car Co.,* 279 U. S. 253 (1929), this Court said (p. 261):

> "It is everywhere recognized that the freedom of the people to enter into and carry out contracts in respect of their property and private affairs is a matter of great public concern and that such liberty may not lightly be impaired. *Steele* v. *Drummond,* 275 U. S. 199, 205. Generally speaking, that right is protected by the due process clauses of the Fifth and Fourteenth Amendments. *Allgeyer* v. *Louisiana,* 165 U. S. 578, 591. *Adair* v. *United States,* 208 U. S. 161, 174. *Coppage* v. *Kansas,* 236 U. S. 1, 14. *Adkins* v. *Childrens Hospital,* 261 U. S. 525, 546. It is also well-established by the decisions of this court that such liberty is not absolute or universal and that Congress may regulate the making and performance of such contracts whenever reasonably necessary to effect any of the great purposes for which the na-

* The fifth case (*Lynch* v. *United States,* 292 U. S. 571, 587; Banks' Brief, p. 67) likewise refers to the "impairment" of contracts (citing two state legislation cases) and does not in any way tend to hold the "impairment" clause of the Constitution to be applicable to the federal legislation involved in that case.

tional government was created. *Frisbie* v. *United States,* 157 U. S. 160, 165. *Addyston Pipe & Steel Co.* v. *United States,* 175 U. S. 211, 228 *et seq. Ellis* v. *United States,* 206 U. S. 246. *Atlantic Coast Line* v. *Riverside Mills,* 219 U. S. 186, 202. *Louisville & Nashville R. R.* v. *Mottley,* 219 U. S. 467, 482. *Baltimore & Ohio* v. *Interstate Commerce Commission,* 221 U. S. 612, 618. *Second Employers' Liability Cases,* 223 U. S. 1, 52; *Gt. Northern Ry.* v. *Sutherland,* 273 U. S. 182, 193."

Clearly the bankruptcy power is one of the express powers vested in the Federal government by the Constitution. And the Banks themselves cite the decision of this Court in *Hanover National Bank* v. *Moyses,* 186 U. S. 181 (1902), in which the Court said of the bankruptcy power of Congress (p. 188): "The grant to Congress involves the power to impair the obligation of contracts and this the States were forbidden to do."*

The *Hanover National Bank* case establishes that if the due process clause imposes any limitation on the bankruptcy power of Congress,† the limitation is only that the acts of Congress must not be "grossly unreasonable" (186 U. S. at p. 192). It follows that when as in this case, the injunction order is based solely upon necessity and for the accomplishment of what is, admittedly, a legitimate exercise of the bankruptcy power, viz., reorganization, such an order cannot be "grossly unreasonable."

This constitutional argument of the Banks, if analyzed, really goes to the constitutionality of one of the foundations of Section 77 and similar new Sections of the Bank-

* And this Court has held that even the states in certain circumstances may impose reasonable limitations on the remedy under mortgage contracts. *Building & Loan Ass'n* v. *Blaisdell,* 290 U. S. 398 (1934).

† It has been vigorously argued that the "due process" requirement of the Fifth Amendment does not impose any restriction upon the bankruptcy power (Gerdes—"Constitutionality of Section 77B of the Bankruptcy Act," XII New York University Law Quarterly Review 196, 207-211 (December, 1934)).

ruptcy Act. The Sections would admittedly be of little value without the power to enjoin the foreclosure of mortgages. The Banks will admit and the R. F. C. will assert that Section 77 and similar new Sections prevent the foreclosure of mortgages. If it is unconstitutional to delay the remedies of pledgees, it is also unconstitutional to delay the remedies of mortgagees. On this point of constitutionality, there can be no possible distinction between them. Both remedies are usually contained in the contract. We submit that it is not unconstitutional to delay either the remedy of the mortgagee or the pledgee for the purpose of effecting a reorganization.*

The Circuit Court of Appeals dealt quite adequately with this untenable constitutional point of the Banks (R., p. 326):

> "As to the constitutionality of Section 77 of the Bankruptcy Act, little need be said in addition to what has already been stated, to show this objection is untenable. If the order assailed deals merely with the remedy, as we hold it does, then the amendments violate no provision of the Constitution. That such restraining orders affect the remedy only, see *Allebach* v. *Thomas*, 16 F. (2d) 853. Likewise, legislation which deals with the subject of bankruptcy, that is, legislation for the benefit and relief of cred-

* The Banks in their Brief (p. 74) point out that mortgaged real estate comes into the possession of the Bankruptcy Court, while pledged securities do not, and urge that because of this difference delay of the remedies of a trustee under a mortgage is a constitutional exercise of the bankruptcy power while delay of the remedies of a pledgee is not. But it is a strange doctrine which here seems to be contended for—that the constitutionality of the exercise by Congress of its bankruptcy power turns on whether the bankrupt had possession of the property at the time of the commencement of the bankruptcy proceedings. We need merely point out that the earlier English and American bankruptcy acts did not render preferences illegal, but protected the diligent creditor's right to the property of which he obtained possession even the day before bankruptcy (Remington on Bankruptcy, 4th Ed., 1934, Vol. I, pp. 13-21); and that the right first introduced into the Bankruptcy Act of 1898 to invalidate preferences secured within four months of bankruptcy has not been held unconstitutional although it changed the pre-existing law and deprived the creditor of property of which he had obtained possession before bankruptcy.

itors and debtors—is not subject to the same constitutional limitations as legislation which deals with other subjects and which affects contractual rights and obligations of debtors and creditors. The grant of power 'to establish * * * uniform laws on the subject of bankruptcy' was necessarily a grant of power the exercise of which would impair the obligation of contracts. For legislation on the subject of bankruptcy contemplated a discharge of the debtor's debts—which is an impairment of contractual obligations. *Hanover National Bank* v. *Moyses*, 186 U. S. 181."

POINT VI.

Section 77 has enlarged the territorial jurisdiction of the District Court in a proceeding under Section 77 so as to permit the issuance of process outside the district in a proper case.

The three Banks which were located outside the Northern District of Illinois, and which were served with notice of the hearing on the application outside the District, make the contention that in a proceeding under Section 77 [11 U. S. C. A., Section 205] the Court had no power to issue process against them. In substance, their argument is based solely on authorities before the enactment of Section 77 holding that generally the process of a United States District Court did not extend beyond the District in which it sat.

But this is a matter for Congress to determine, as was said in the leading case of *Toland* v. *Sprague*, 37 U. S. (12 Pet.) 300, 328 (1838). There this Court stated:

> "Congress might have authorized civil process from any circuit court, to have run into any state of the Union;".

This proposition has never been questioned. In fact, Congress has specifically provided that all writs of execution upon judgments obtained for the use of the United States may run to and be executed in any State or Territory.

> R. S., Section 986 [28 U. S. C. A., §839];
> *Pierce* v. *United States*, 255 U. S. 398 (1921).

Similarly, where any State is divided into two or more districts, writs of execution may be executed in any part of such State.

> R. S., Section 985 [28 U. S. C. A. §838].

Likewise, subpoenas may run beyond the territorial limits of the District Court, provided that the distance is not greater than one hundred miles from the place where court is held.

> R. S., Section 876, as amended by Act of Sept. 19, 1922, c. 344, 42 Stat. 848 [28 U. S. C. A. §654].

Accordingly, the problem presented involves simply a question as to whether or not Congress has expressly or impliedly given authority for orders issued in aid of proceedings under Section 77 to become effective outside the district. Upon this point subdivision (a) of Section 77 [11 U. S. C. A. §205 (a)] expressly provides;

> "If the petition is so approved, the court in which such order approving the petition is entered shall, during the pendency of the proceedings under this section **and for the purposes thereof, have exclusive jurisdiction of the debtor and its property wherever located.**"

Congress was obviously aware that railway lines of each one of the large railroad systems of the country ran into many Federal districts and circuits and States. For ex-

ample, the railway lines of the Rock Island parent company itself run into eleven states. Therefore when Congress gave exclusive jurisdiction over the proceedings involving such railway lines to one District Court, it must have intended to permit its process to run into other districts.

Furthermore, the sixth sentence of subdivision (a) of Section 77 provides that any subsidiary company or company owning a leased line, wherever it, or its property, may be situated, may come into the proceeding in the original District Court in which the principal debtor files its petition. This would be an absurd provision if that District Court were not then impliedly empowered to issue process in any part of the United States where the property of any of the debtors in the proceeding is located.

Section 77B of the Bankruptcy Act [11 U. S. C. A. §207] providing for the reorganization of industrial corporations, has been construed by the Circuit Court of Appeals for the Second Circuit to give the United States District Court in the Southern District of New York jurisdiction to issue its process directed outside of the District to require acts to be done outside the District.

> *In the Matter of Greyling Realty Corporation, Debtor,* Circuit Court of Appeals, Second Circuit, January 7, 1935, New York Law Journal, January 17, 1935, page 1.

In that case in an unanimous opinion the Court said:

> "It is argued that the district court has not the power to issue its process throughout the United States. Section 77A provides that 'in addition to the jurisdiction exercised in voluntary and involuntary proceedings to adjudge persons bankrupt, courts of bankruptcy shall exercise original jurisdiction in proceedings for the relief of debtors, as provided in §77B of this act.' And §77B expressly grants to the court approving the petition, during

the pendency of the proceedings under this section, exclusive jurisdiction of the debtor and its property wherever located for the purpose of the section. The power to issue its process throughout the United States in furtherance of the purposes of a centralized reorganization is an inevitable conclusion because of vesting such power in the district court of primary jurisdiction. Sec. 77B, para. (c) (10)."

A similar extension of the territorial jurisdiction of the United States District Court has been implied from the necessity arising in enforcing other Federal statutes, even in the face of the express provisions of the Judicial Code restricting the District Court's territorial jurisdiction. In a number of cases decided by this Court and the lower Federal courts it has been established that where a statute vests a particular district court with exclusive jurisdiction of a suit or special proceeding, such a statute repeals *pro tanto* the general statutes relating to jurisdiction of the district courts, and authorizes the particular district court to issue its process throughout the United States.

First National Bank v. *Williams*, 252 U. S. 504 (1920);

Ex Parte Southwestern Surety Ins. Co., 247 U. S. 19 (1918);

United States v. *Congress Const. Co.*, 222 U. S. 199 (1911);

National Fire Ins. Co. v. *Sanders*, 38 F. (2d) 212 (C. C. A. 5th, 1930);

Southern Paving Const. Co. v. *City of Knoxville*, 245 Fed. 421 (C. C. A. 6th, 1917);

Baker Contract Co. v. *United States*, 204 Fed. 390 (C. C. A. 4th, 1913);

Fischer v. *Palmer*, 259 Fed. 355 (D. C., M. D., Pa., 1919);

United States v. *Illinois Surety Co.*, 238 Fed. 840 (D. C., E. D. N. C., 1917).

In *United States* v. *Congress Const. Co.*, 222 U. S. 199 (1911), *supra*, the suit was on a bond for performance of a building contract. The statute under which the bond was given provided that an action for performance of the bond could be instituted only in the district in which the building contract was to be performed. The United States brought the action in the district of which the defendants were inhabitants, which was not the district where the contract was to be performed. Some of the defendants moved to dismiss on the ground that that particular district court did not have jurisdiction. The United States, on the other hand, urged that the defendants could not be served with process except in the district in which the suit was brought and, therefore, suit could not be maintained in any other district. This court held that the suit was properly dismissed since it should have been brought in the district where the contract was to be performed, and further said that upon a suit being brought in the proper district, the process of that district court could be served on the defendants anywhere in the United States. After holding that the provision in the statute for bringing the suit in the district where the building contract was to be performed was binding on the United States, the Court said (p. 203):

> "The contention to the contrary is rested largely upon the supposition that, in instances like the present, where the defendants, or some of them, are inhabitants of another district, there is an insuperable barrier to the maintenance of the action in the district wherein the contract was to be performed. But this supposition is a mistaken one, for the provision restricting the place of suit operates *pro tanto* to displace the provision upon that subject in the General Jurisdictional Act, 25 Stat. 433, c. 866, §1, and amply authorizes the Circuit Court in the district wherein the action is required to be brought to obtain jurisdiction of the persons of the defendants

through the service upon them of its process in whatever district they may be found."

In *National Fire Ins. Co.* v. *Sanders*, 38 F. (2d) 212 (C. C. A. 5th, 1930), *supra*, an interpleader bill was filed by insurance companies in a district court under an act providing that an insurance company could file such a bill where there were two or more adverse claimants, citizens of different states. The act vested jurisdiction in the district court in the district within which one of the claimants resided. Before the bringing of this suit one of the claimants had brought suit in a state court, and the district court held that the state court had obtained jurisdiction to the exclusion of any other court. The Circuit Court of Appeals reversed and held that the action in the state court could be enjoined and that such injunction process could be served outside the district, saying (p. 215):

> "Furthermore, it is well settled that a federal court may issue an injunction to the parties litigant in a state court in order to preserve its jurisdiction properly attaching. Simon *v.* So. R. Co., 236 U. S. 115, 35 S. Ct. 255, 59 L. Ed. 492. And, when jurisdiction is specially vested, the process of the District Court may be served anywhere in the country. U. S. *v.* Congress Const. Co., 222 U. S. 199, 32 S. Ct. 44, 56 L. Ed. 163."

Section 77 specifically vests the United States District Court for the Northern District of Illinois with "exclusive jurisdiction" of this reorganization proceeding. It is plain from the above cases that this grant of jurisdiction to that Court carries with it the power of that Court to protect and carry out that jurisdiction by serving its process throughout the United States.

There is no basis, therefore, for the argument of these three Banks that under Section 77 the Court's territorial jurisdiction is no different from what it was under the old

Bankruptcy Act. As the R. F. C., and even these three Banks, point out in their briefs (R. F. C. Brief, p. 60; Banks' Brief, pp. 35, 87), one of the purposes of Section 77 was to do away with the expense, delay and inconvenience of ancillary proceedings.

Accordingly, the express provisions of Section 77 change the old territorial boundaries of the jurisdiction of the District Court for purposes of proceedings under Section 77.

In any event, the contention of the three non-resident Banks has no application to the issuance of this injunction against the other petitioners. If the injunction is sustained as to these other petitioners and ancillary process is held to be required in the case of the three non-resident Banks, ancillary process can be obtained, although we think avoidance of the necessity and expense thereof was one of the purposes of the enactment of Section 77.

The Circuit Court of Appeals, in ruling in this case against this contention of the three Banks, said (R., p. 322):

> "There were no legal obstacles to Congress' making the jurisdiction of the court of bankruptcy co-extensive with the territorial boundaries of the United States. In fact, under existing provisions of the Constitution, Congress might validly extend the jurisdiction of any District Court to the entire United States. *U. S.* v. *Union Pacific*, 98 U. S. 569, 604. There were strong reasons for extending the jurisdiction of the court of bankruptcy in railroad cases.
>
> "No sufficient reason has been advanced for refusing to give to the language of this section ('have exclusive jurisdiction of the debtor and its property wherever located') the effect and construction which it clearly demands. It extended the court's jurisdiction over the debtor's property so as to include the entire United States. It was intended to and did wisely exclude ancillary receivership proceedings

in bankruptcy cases wherein railroad corporations were the bankrupts.

"The question, Was the collateral with which the debtor secured its loans from the appellants, property as that word is used in Section 77? we answer in the affirmative. It is true a debt is not an asset. It is a liability. But here the bonds which the debtor gave the creditor as security (largely debtor's bonds) were not transferred absolutely to the creditor. An equity therein existed and belonged to the debtor. The debtor could sell this equity. It could assign it. The bonds were secured by a mortgage on debtor's property, and each bond carried its pro rata share of the mortgaged security. The same may be said of the bonds of the debtor's subsidiaries.

"This construction of the act overcomes the objection of those appellants who by special appearance attacked the order on the ground that the property of the bankrupt corporation was not within the territorial limits of the district wherein the court who entered the order was residing. We hold this was not necessary, for the arm of the court extended to the property of bankrupt 'wherever located'—that is, anywhere in the United States. In short, the jurisdiction of the court, so far as the property was concerned, included the territory wherein all of appellees' bonds were located."

POINT VII.

Discussion of general economic considerations urged by the R. F. C. and the Banks.

Before discussing the economic considerations urged by the petitioners we wish to point out that the paramount economic question to be considered as directly involved in this case is whether the sale of the $200,000,000 of System

collateral is to be enjoined so as to permit a reorganization of the Rock Island System, with its System properties* intact, or whether the extraordinary doctrine of corporate disintegration advocated by the R. F. C. is to be applied and the Rock Island System is to be dismembered without plan, but solely in accordance with the whim or exigencies of its pledgee creditors. In urging this doctrine in its brief, the R. F. C. states (Brief, p. 71):

> "A major economic corrective to this concentration [of subsidiaries' stocks and bonds] is the attrition which becomes possible, when a railroad after pledging its assets, defaults. If this form of securing short-term notes is eliminated the railroad will tend to go into receivership with this body of assets intact. Rarely has there been substantial dispersion of these assets [subsidiaries' stocks and bonds] as a result of reorganization. Rather, they are dealt with so that the railroad's property, including stock and bond interests in other corporations, emerges nearly intact. Almost the only avenue by which they can be dispersed is through direct sale, or sale to pay off collateral loans, and their passage into the hands of a creditor."

But certainly the whole effort of the Government for decades has been toward consolidation of railroad systems and the taking over and retention by great systems, of short lines, bridge lines, belt lines and terminals. In fact, the R. F. C. was created not to disintegrate, but to preserve the railroad systems as well as other institutions of the country.

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* The R. F. C. tries to imply that all of the subsidiary companies, bonds of which are held by it as collateral, may not be really appurtenant to, or parts of, the System and should be lopped off. Yet the R. F. C. itself has submitted to this Court in its Appendix (p. 27) the report of the I. C. C. giving the basis on which the R. F. C. made part of the advance and obtained most of the collateral, which shows that all such bond collateral is secured by properties which are an integral and essential part of the Rock Island System.

The R. F. C. and the Banks argue that it would be inconvenient for them to be restrained from the free right of sale of their collateral pending reorganization, and that such a restriction would make the R. F. C. and the Banks reluctant to give loans to railroad corporations *in extremis* on the security of collateral consisting of obligations of the railroad systems. We submit there is no sound public policy fostering the practice of managements of railroad corporations making desperate eleventh hour efforts to stave off insolvency proceedings and stay in control through a reckless pledge of system obligations far exceeding in principal amount the funds received and indebtedness secured. When the point is reached where a railroad corporation can obtain funds only through pledging secured obligations of its own system which in face amount ($54,000,000) are three times the amount of the loan ($17,000,000), the transaction would appear to be improvident and without due regard to the interests of existing creditors. There is no public policy dictating that railroad managements should have a free field for obtaining money on these terms. The recent "Report of the Federal Coordinator of Transportation to the Interstate Commerce Commission" of January 21, 1935, transmitted to the President and the Congress on January 21, 1935, states (Vol. I, pp. 56, 61):

> "As time went on, it began to be evident • • • that the policy of rolling up further indebtedness through government loans, and stripping the carriers of collateral in the process, was not sound or in the ultimate interest of their creditors.
>
> • • • • • •
>
> "No good will be accomplished by piling up indebtedness through Reconstruction Finance Corporation loans, unless the carrier has a substantially sound financial structure so that some measure of private credit is likely to be gained rather quickly with an upturn in business. It is better that carriers

not so situated should be permitted to avail themselves of the Bankruptcy Act. Nothing is to be gained by prolonging and intensifying unsound conditions.'"*

The table of increasing railroad receiverships set forth by the R. F. C. (R. F. C. Brief, pp. 76, 77), is proof that the chances of a railroad in weak financial condition pulling through by means of loans on collateral consisting of their system bonds in disproportionately large amounts, are meager, and that it is almost inevitable that its creditors will be sacrificed without any ultimate benefit to the road.

Furthermore, we have already mentioned (p. 22) that the loans in this case were not made as ordinary current bank loans on the basis of quick realization on the collateral. The original long term of the loans (about 19 months) and the character and amount of the collateral taken by the petitioners shows that they were not contemplating so-called quick loans (six months or less) on readily marketable securities or relying on a quick realization for their protection (R., pp. 44-55). Most of the collateral required by the R. F. C. was unlisted and had no ready market (R., p. 38; App. to R. F. C. brief, p. 41; 184 I. C. C. 597). The total face amount of the collateral required by the Banks and the R. F. C. to be given in pledge was so excessive as to show it was not of a type customarily taken by banks for really current loans (R., pp. 37-39). Clearly, it has not been the policy of the R. F. C. merely to make quick loans but on the contrary it was the primary purpose of its creation to furnish funds to institutions as well as railroads on "frozen" collateral having no market. In fact, a portion of the R. F. C. loan here was made to "bail out" these Banks to the extent of one-half of a "frozen" loan (App. to R. F. C. brief, pp. 27-29). That it was not the intention of Congress that the R. F. C. should make

* Cf. Wehle—"Railroad Reorganization Under Section 77 of the Bankruptcy Act"; 44 Y. L. Jour. 197, 202, footnote 21.

quick loans such as could be made at commercial banks, but that Congress intended that the R. F. C. should make loans only on "frozen" collateral, is conclusively shown by Section 5 of the R. F. C. Act quoted at page 80 of the R. F. C. brief providing that the R. F. C. could make loans to railroads only "when in the opinion of the board of directors of the corporation such railroads or railways **are unable to obtain funds upon reasonable terms through banking channels** or from the general public, and the corporation will be adequately secured."

However that may be, the real value of this collateral does not depend upon the fluctuating market value of the bonds, but lies in the value of the System properties upon which such bonds are a lien, and the bonds held as collateral constitute a lien on the System properties in an amount three times the face amount of the loans. The reports of the Interstate Commerce Commission approving the applications for the loans show that the Commission was relying solely on the value of the System properties underlying the mortgage bond collateral for the security of the loans. The Commission stressed the System's value for rate making purposes, and found it to be $594,090,000 compared with a capital structure at the time of $130,799,212 of capital stock and $317,372,895 of funded debt (App. to R. F. C. Brief, pp. 37-45; 184 I. C. C. 597).

In view of the low market quotations for the listed collateral and the absence of a market for the unlisted collateral and of the statement of the R. F. C. (R. F. C. Brief, p. 5) regarding its authority to purchase the collateral itself, it is obvious that the petitioners have no intention of actually realizing on the collateral by sale to third parties, but that they intend to sell to themselves and thus treble their claims. In this connection, we should also call attention to the assertion made by petitioners in the Circuit Court of Appeals that they did not contemplate the sale of the collateral. As to this, the Circuit Court of Appeals said (R., pp. 325-326):

> "Appellants' attack on the merits is somewhat unique. They do not object to the terms of the order for they do not contemplate the sale of the pledged collateral. They object to being ordered. If the court may make such an order, and we hold it can, little attention need be given to an objection which if sustained would be destructive of that cooperative action which is so essential in the readjustment of the debtor's debts and its capital structure or in the reorganization contemplated by Section 77."

Furthermore, holders of mortgage bonds are accorded the same treatment as the petitioners under Section 77. They are not permitted to foreclose and yet they are not receiving interest and, if the System properties behind the collateral held by the Banks and the R. F. C. are declining in value, the properties securing these mortgage bonds are also declining in value to the same extent because they are the same properties. So far as concerns the statement that the Banks and the R. F. C. were surprised to find that their remedy of selling collateral might be enjoined after the enactment of Section 77, the holders of mortgage bonds were equally surprised when they learned that their right to foreclose was to be enjoined under Section 77. And at any rate, it should have been no complete surprise to the petitioners herein because one of them, Mississippi Valley Trust Company, had previously been enjoined from the sale of similar collateral in the equity receivership of the Missouri, Kansas & Texas Railway.

> *Mississippi Valley Trust Company* v. *Railway Steel Spring Co.*, 258 Fed. 346 (C. C. A. 8th, 1919).

It should be borne in mind that no attack whatever has been made on the validity of the collateral or the position to be accorded the petitioners in the plan of reorganization on account of their holding this large amount of collateral. In fact, petitioners have received approximately $376,000

through distributions on their collateral between September 26, 1933, and October 24, 1934 (R., p. 342).

The R. F. C. contends that, if the Courts can enjoin the sale of collateral of this type in proceedings under Section 77, loans with collateral of this type will be discouraged contrary to the policy of Congress to foster such loans. It is unsound that a holding that there is a right to issue such injunctions will discourage loans. As we have pointed out right along, loans of this type are made, not on a quick realization basis, but on the long-view intrinsic worth of the System properties underlying the bonds comprised in the collateral. That this is so is shown by the fact that, according to a study of public statistics, since November, 1933, when this injunction was issued (the issuance of the injunction was widely known in railroad and financial circles and, of course, to the R. F. C. and these five Banks), at least $221,000,000 of loans to railroads on pledged collateral have been made by the R. F. C., the P. W. A. and by banks (including two of the petitioning banks). And Congress has not fostered loans with any particular type of security and the argument is unsound from that standpoint. If it were true, as the R. F. C. argues, that the existence of the right to issue such an injunction against the sale of pledged collateral under Section 77 will discourage such loans, then Congress has discouraged long-term mortgage loans for railroads by providing that foreclosure of mortgages may be enjoined under Section 77. The R. F. C. cannot mean that Congress is encouraging short-term loans as contrasted with long-term permanent mortgage financing for railroads when all the public statements of the Administration encourage permanent financing as opposed to temporary credit expedients. Here it is appropriate to call attention to the petitioners' assertion that if the issuance of an injunction against the sale of pledged collateral takes away the advantage of one class of creditors for the benefit of another, it is improperly discriminatory. Yet, this is just what has

occurred in the case of mortgage bonds, the foreclosure of which may be enjoined.

Conclusion.

The petitioners and the Banks try to deal with this application and appeal as if it were a dispute between private litigants, each striving to establish his rights in a fund or to diminish the other's claims,—that is, as if the holders of the System's outstanding bond issues and the Railway Company itself were attacking the Banks and the R. F. C. to diminish the claims of the latter or in order to take property rights from them.

This is not so. The order in question is purely an administrative and procedural matter and the dispute lies rather between the Federal District Court and the petitioners than between the respondents and the petitioners. The respondents are simply upholding the hands of the Federal District Court in its effort to administer this proceeding for the reorganization of the Rock Island System in such a way that a successful reorganization can take place and the System be placed once more on its own feet.

Congress has given the Federal District Court the onerous task of guiding the reorganization proceeding, of overcoming the many procedural obstacles and bringing the proceeding to a successful conclusion. The effectiveness of the reorganization machinery inserted by Congress in the Bankruptcy Act and the ability of the Federal District Courts to operate that machinery and put many of our major railroad systems back on their feet and restore to good standing their securities, which are in the hands of life insurance companies, savings banks, trustees and other investors, is at stake. With this issue raised at a time when every effort of the administration and the Federal and State Governments is bent along constructive lines any mere procedural inconvenience which may be suffered by the R. F. C. and the Banks should not bear great weight.

The Federal District Court through its handling of all the phases of this particular reorganization proceeding

has a broad background against which it can view the obstacles to the completion of its task—a successful reorganization—and is in the best position to determine, and has determined, that the sale of this collateral is such a major obstacle that an injunction against the sale was necessary to effect a reorganization and carry out the sole purpose of the proceeding. The Circuit Court of Appeals has confirmed this determination.

We submit that this Court should view this determination of the Courts below on this administrative matter, vitally affecting their efforts to accomplish a reorganization, even more sympathetically than their determination of a question merely involving the private rights of two litigants. We urge that it should not render a decision which would result in impeding the steps taken by the District Court in furtherance of its onerous duty unless the District Court has acted without any shadow of authority. This the District Court has not done. On the contrary, it had ample power and authority for the order, as the Circuit Court of Appeals has held and as has been shown herein.

The Order of the District Court should be affirmed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1934.

Nos. 479-490.

In the Matter of
THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY CO., *Debtor.*

Nos. 479 and 480
CONTINENTAL ILLINOIS NATIONAL BANK & TRUST COMPANY, *Petitioner,* v. THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY, ET AL., *Respondents.*

Nos. 481 and 482
THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, *Petitioner,* v. THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY, ET AL., *Respondents.*

Nos. 483 and 484
MISSISSIPPI VALLEY TRUST COMPANY, *Petitioner,* v. THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY, ET AL., *Respondents.*

Nos. 485 and 486
HARRIS TRUST & SAVINGS BANK, *Petitioner, v.* THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY, ET AL., *Respondents.*

Nos. 487 and 488
THE NEW YORK TRUST COMPANY, *Petitioner,* v. THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY, ET AL., *Respondents.*

Nos. 489 and 490
RECONSTRUCTION FINANCE CORPORATION, *Petitioner,* v. THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY, ET AL., *Respondents.*

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF OF RESPONDENT, PROTECTIVE COMMITTEE FOR THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY GENERAL MORTGAGE BONDS

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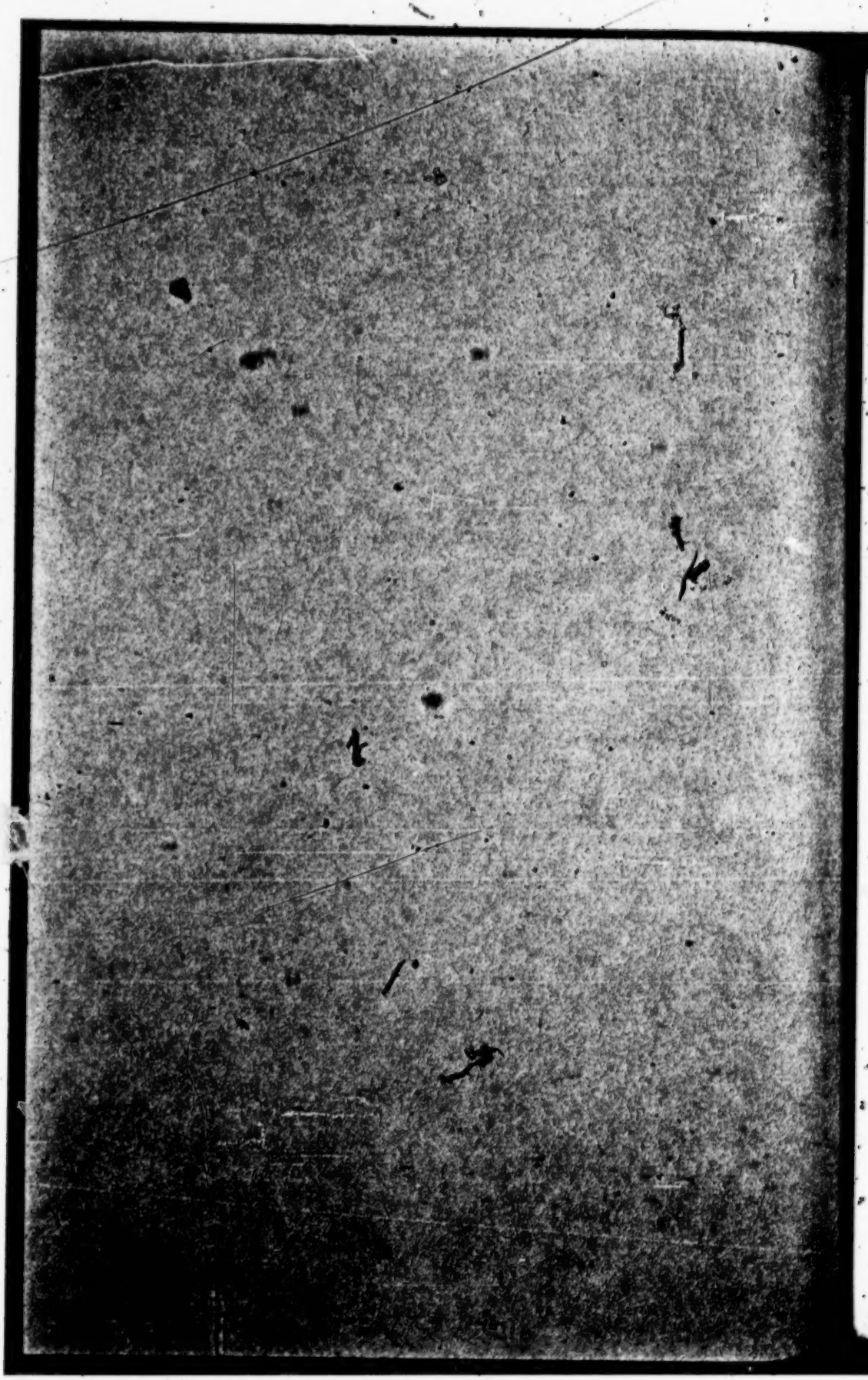

INDEX

	PAGE
OPINIONS BELOW	1
JURISDICTION	2
QUESTION PRESENTED	2
STATEMENT OF THE CASE	2-11
1. The Debtors in the Proceeding	2-3
2. The Other Parties to the Proceeding	3-4
3. The Position of the General Mortgage Committee as Compared with the Position of the Other Respondents	4-5
4. The Necessity for the Order Below; The Relation Thereto of the Pledgees' Demand for Interest	6-7
5. The Order Under Review and the Record on Which It Was Made	7
6. The Pledgees' Collateral	7-11
SUMMARY OF THE ARGUMENT	11-13
ARGUMENT	13
I. THIS CASE DOES NOT INVOLVE THE RIGHT OF PLEDGEES TO SELL ORDINARY COLLATERAL	13-14
II. THE PLEDGED CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY FIRST AND REFUNDING BONDS DO NOT REPRESENT DEBTS OF THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY. THEY MERELY REPRESENT FRACTIONAL INTERESTS, HELD AS SECURITY ONLY, IN PROPERTY WHICH IS PART OF THE PRINCIPAL DEBTOR'S ESTATE	14-16

PAGE

A. The status of the pledged First and Refunding Bonds prior to the bankruptcy 15-16

B. When the order appealed from was entered in the District Court on November 22, 1933, the pledged bonds still had the same attributes which they had before the commencement of the proceeding 16

III. AS A RESULT OF THE COMMENCEMENT OF THE PROCEEDING UNDER SECTION 77 OF THE BANKRUPTCY LAW, EACH PLEDGEE IS SIMPLY A SECURED CREDITOR OF THE PRINCIPAL DEBTOR, HOLDING A SINGLE CLAIM. TRANSFERS OF THE PLEDGED FIRST AND REFUNDING BONDS, IF RECOGNIZED, WOULD BE MERELY TRANSFERS OF RATABLE SHARES OF THE LIEN OF THE MORTGAGE. NO PLEDGEE HAS ANY POWER TO TRANSFORM THE PLEDGED BONDS INTO DEBTS BY TRANSFERRING THEM TO SOMEONE ELSE 16-26

A. The status of the pledged bonds is to be determined by the Bankruptcy Act 17-18

B. In bankruptcy a creditor holding unsecured bonds of the bankrupt as security cannot prove a claim on the bonds themselves, but can only prove for the amount actually owing 19-21

C. In bankruptcy a creditor holding a mortgage bond of the bankrupt as security only cannot prove a claim on the bond, but can only prove for the debt actually owing 21-23

PAGE

D. If the pledged bonds did not constitute debts when the Principal Debtor filed its petition under Section 77, transfers thereof by the pledgees, if recognized, will merely convey to the transferees ratable shares in the lien of the mortgage. For the pledgees cannot transform the pledged bonds into debts by the mere act of transferring them to someone else after the bankruptcy 23-25

E. The fact that pledged mortgage bonds may appear from a casual inspection to be negotiable instruments is immaterial 26

F. Decisions relating to transfers of pledged collateral in equity proceedings have no bearing here 26

IV. SECTION 77 OF THE BANKRUPTCY ACT CONTEMPLATES ACTION BY THE VARIOUS CLASSES OF CREDITORS. THE TRANSFER OF THE PLEDGED FIRST AND REFUNDING BONDS, IF RECOGNIZED IN THE BANKRUPTCY COURT, WOULD CREATE A NEW CLASS OF "CREDITORS" AS DEFINED IN SECTION 77.

FORMULATION OF A PLAN WOULD BE IMPOSSIBLE IF TRANSFERS OF THE BONDS WERE TO BE PERMITTED WITHOUT CONTROL AND RECOGNIZED, BECAUSE IT WOULD BE IMPOSSIBLE TO KNOW WHAT CLASSES TO PROVIDE FOR AND WHAT CLAIMS 27-33

A. Each of the pledgees belongs within a single class of creditors; its total claim falls within that class; and its